Supreme Court, U.S.
FILED

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No. _____

In the
Supreme Court of the United States

KATHRYN CHESHIRE,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

JOSEPH (SIB) ABRAHAM, JR.
Counsel of Record

THIRD FLOOR TOLTEC BUILDING
717 EAST SAN ANTONIO STREET
EL PASO, TX 79901-2520
(915) 544-7860

Counsel for Petitioner

BECKER GALLAGHER LEGAL PUBLISHING, INC.,
CINCINNATI, OHIO 800-890-5001

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QUESTION PRESENTED

Kathryn Cheshire filed a joint income tax return with her husband for the year 1992. Mrs. Cheshire's husband led her to believe that their joint return accurately reported the taxable amount of his retirement distribution when in fact it did not. After the spouses divorced, the 1992 joint income tax return was audited by the Internal Revenue Service. Kathryn Cheshire timely elected to be taxed as if she and her ex-husband had filed separate tax returns pursuant to the newly enacted "separate liability" election contained in Internal Revenue Code §6015(c). The United States Tax Court and the United States Court of Appeals for the Fifth Circuit, both interpreting the limitation on separate liability elections contained in Internal Revenue Code §6015(c)(3)(C) for the first time, held that although Kathryn Cheshire honestly believed that her husband's retirement distribution had been correctly reported, nevertheless, she was not entitled to separate her tax liability from that of her husband as if they had filed separate tax returns pursuant to I.R.C. §6015(c) because she had actual and clear awareness of the retirement distribution and how it was spent. Appendix B, page 23a.

The question presented here is:

> Whether, for purposes of the limitation on separate liability elections contained in I.R.C. §6015(c)(3)(C), actual knowledge of "any item giving rise to a deficiency" means actual knowledge of an erroneous entry on a joint tax return or simply actual knowledge of a financial transaction.

LIST OF PARTIES

Petitioner Kathryn Cheshire is an individual with no corporate affiliations.

Respondent is the Commissioner of Internal Revenue.

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PETITION FOR WRIT OF CERTIORARI

KATHRYN CHESHIRE respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on February 8, 2002. The Fifth Circuit has decided an important question of law that has not been, but should be settled by this Court.[1]

OPINIONS BELOW

The opinion of the United States Tax Court is published at 115 T.C. 183 (2000) and is reprinted in Appendix C hereto. The opinion of the United States Court of Appeals for the Fifth Circuit that gives rise to this petition is published at ___ F.3d___ (5th Cir. 2002) and is reprinted in Appendix B hereto. By order filed April 9, 2002, the Fifth Circuit Court of Appeals denied the petition for rehearing in banc. Appendix A hereto.

JURISDICTION

The United States Tax Court entered its decision determining that petitioner owed a deficiency in tax for the year 1992 in the amount of $47,934.00 on November 14, 2000. Petitioner timely appealed the Tax Court's decision to the United States Court of Appeals for the Fifth Circuit. The Fifth Circuit affirmed the decision of the Tax Court in an

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[1] On June 14, 2002, the United States Court of Appeals for the District of Columbia addressed the same issue present in the instant case in *Mitchell v. Commissioner*, Docket No. 01-1045. The Mitchell interpretation of §6015(c)(3)(C) is consistent with the Fifth Circuit's interpretation in the instant case.

opinion filed on February 8, 2002. On April 9, 2002, the Fifth Circuit denied petitioner's timely filed petition for rehearing en banc. Pursuant to Supreme Court Rule 13.1, this petition has been filed within ninety (90) days of the Fifth Circuit's denial of rehearing.

The jurisdiction of the Court is invoked pursuant to 26 U.S.C. §7482 and 28 U.S.C. §1254(1).

STATUTES INVOLVED IN THIS CASE

The entire text of Internal Revenue Code §6015 is reprinted in Appendix D hereto.

The portions of Internal Revenue Code §6015 relevant to this case are as follows:

Internal Revenue Code §6015(c), entitled "Procedures to limit liability for taxpayers no longer married or taxpayers legally separated or not living together", provides as follows at subsection (1):

> "(1) In general
>
> Except as provided in this subsection, if an individual who has made a joint return for any taxable year elects the application of this subsection, the individual's liability for any deficiency which is assessed with respect to the return shall not exceed the portion of such deficiency properly allocable to the individual under subsection (d)."

Internal Revenue Code §6015(c)(3)(C), entitled "Election not valid with respect to certain deficiencies", provides as follows:

> "If the Secretary demonstrates that an individual making an election under this subsection had actual knowledge, at the time such individual signed the return, of any item giving rise to a deficiency (or portion thereof) which is not allocable to such individual under subsection (d), such election shall not apply to such deficiency (or portion). This subparagraph shall not apply where the individual with actual knowledge establishes that such individual signed the return under duress."

STATEMENT OF THE CASE

The facts in this case are undisputed. Kathryn Cheshire is a fifty-three year old elementary school teacher who is divorced and has two children from her marriage to her former husband, David Cheshire. Kathryn Cheshire and David Cheshire were married on June 20, 1970. Upon graduating from college in 1970, Kathryn Cheshire taught elementary school for approximately three years, then took off approximately ten years to raise her two minor children, and then returned to teaching elementary school and has continued teaching elementary school at all times thereafter. In 1992, David Cheshire decided to take early retirement from his employment with Southwestern Bell in order to start his own business. As a result of his retirement from Southwestern Bell, David Cheshire received retirement distributions totaling $229,924 in 1992. Of this amount, $42,183.00 was rolled over into a qualified account and

approximately $99,425 was used to pay off the mortgage on the Cheshires' homestead. During the year 1992, Kathryn Cheshire was employed as an elementary school teacher and had taxes withheld from her wages in an amount sufficient to cover the tax liability attributable to her teaching income.

For twenty years, David Cheshire had prepared and filed the Cheshires' joint federal income tax returns. Likewise, David Cheshire prepared the spouses' 1992 joint income tax return. Line 17a of the 1992 return reported a total retirement distribution in the amount of $199,771 and line 17b reported $56,150 as the taxable amount of the distribution. Before signing the 1992 tax return, Kathryn Cheshire questioned her husband regarding the tax consequences of the retirement distribution. In response, David Cheshire advised his wife that he had consulted a respected local C.P.A. and had been advised by the C.P.A. that the proceeds used to pay off the mortgage on their home reduced the taxable amount of the retirement distribution, as did the $42,183 rolled over into a qualified account. Accepting her husband's explanation, Kathryn Cheshire signed the 1992 tax return. In reality, David Cheshire had not consulted an accountant and the $99,000 used to pay off the mortgage did not reduce the taxable amount of the retirement distribution. David Cheshire had affirmatively lied to his wife and successfully deceived her into believing that the taxable amount of his retirement distribution had been properly reported on their 1992 joint income tax return.

Kathryn and David Cheshire permanently separated on July 13, 1993, as a result of David Cheshire's persistent problems with alcohol. They were divorced on December 5, 1994. Kathryn Cheshire was awarded the family home in the divorce. David Cheshire was ordered to make monthly child

support payments. David Cheshire made the first payment and has not made a single child support payment since then.

Subsequent to their divorce, Kathryn Cheshire and her ex-husband, David Cheshire, were audited by the Internal Revenue Service for the year 1992. The Commissioner determined that the 1992 return understated the taxable amount of David Cheshire's retirement distribution. Kathryn Cheshire petitioned the United States Tax Court for a re-determination of the tax deficiency based on the argument that she was entitled to relief from joint liability under the newly enacted provisions of Internal Revenue Code Section 6015. In addition to providing traditional "innocent spouse" relief in §6015(b), newly enacted section 6015(c) allows divorced and separated spouses to elect to limit their liability for any deficiency assessed with respect to a joint income tax return to that portion of the deficiency allocable to the electing spouse (the "separate liability election"). The separate liability election is not permitted, however, if the Secretary demonstrates that the electing spouse had actual knowledge of "any item giving rise to a deficiency".

Neither party in this case has ever disputed the fact that the deficiency attributable to the 1992 retirement distributions is properly allocable to Mr. Cheshire. However, the Internal Revenue Service took the position that Kathryn Cheshire's knowledge of the retirement distribution prevented her from making the separate liability election under I.R.C. §6015(c). On the other hand, Kathryn Cheshire contended that because she did not have actual knowledge that the taxable amount of the retirement distribution was incorrectly reported on the tax return, she was entitled to separate her tax 1992 tax liability from that of her ex-husband under I.R.C. §6015(c). The United States Tax Court found that Kathryn Cheshire (1) had inquired in good faith as to

whether the return was correct, (2) was assured by her husband that it was correct, and (3) had no obligation to inquire further. Nevertheless, the majority of the Tax Court held that Kathryn Cheshire was prohibited from making the separate liability election under section 6015(c) because she had actual knowledge of the retirement distribution. However, Justices Parr, Colvin, Marvel and Gale dissented from the majority's opinion on the basis that "actual knowledge of any item giving rise to a deficiency" means knowledge that that the return is incorrect, not mere knowledge that there was an income producing activity or transaction. Appendix C, page 63a. A Rule 155 decision was entered on November 14, 2000, determining that Kathryn Cheshire owed additional taxes for the year 1992 in the amount of $47,934 (excluding interest on the deficiency).

Kathryn Cheshire timely filed a notice of appeal on November 20, 2000. Due to the exceptional importance of the decision in this case, a motion for leave to file an amicus curiae brief was filed by eight prominent tax attorneys who had worked on innocent spouse cases and legislation for more than a decade each. The Fifth Circuit granted the motion on May 31, 2001. Oral argument was heard on November 6, 2001. The Fifth Circuit panel affirmed the Tax Court majority holding that Kathryn Cheshire did not qualify for the separate liability election under section 6015(c) because of her awareness of the retirement distribution. Kathryn Cheshire timely filed a petition for rehearing in banc which was denied by the Fifth Circuit on April 9, 2002. Appendix A, page 1a.

REASONS FOR GRANTING THE WRIT

LEGISLATIVE HISTORY MANDATES A FINDING THAT "ACTUAL KNOWLEDGE" WITHIN THE MEANING OF I.R.C. §6013(c)(3)(C) REQUIRES KNOWLEDGE OF AN ERROR ON THE RETURN AT THE TIME OF FILING.

Generally, spouses who file a joint income tax return are subject to joint and several liability for any tax deficiency assessed with respect to the joint return. I.R.C. §6013(d)(3). Due to the often harsh and inequitable ramifications of joint and several liability, Congress enacted I.R.C. §6013(e), the so-called "innocent spouse" statute which relieved spouses from joint liability where:

> (A) a joint return had been made for a taxable year,
>
> (B) on such return there was a substantial understatement of tax attributable to grossly erroneous items of one spouse,
>
> (C) the other spouse established that in signing the return he or she did not know, and had no reason to know, that there was such substantial understatement, and
>
> (D) taking into account all the facts and circumstances, it was inequitable to hold the other spouse liable for the deficiency in tax for such taxable year

> attributable to such substantial understatement,

Over time, section 6013(e) was strictly construed by the courts and the statute provided limited relief. For instance, in unreported income cases, a taxpayer could not qualify for "innocent spouse" relief under former I.R.C. §6013(e) if the taxpayer had knowledge of the transaction which led to the understatement. *Reser v. Commissioner*, 112 F.3d 1258, 1267 (5th Cir. 1997). Due to the limited relief available and the recurring injustices arising under I.R.C. §6013(e), in 1998 Congress repealed former §6013(e) and enacted I.R.C. §6015.

Internal Revenue Code §6015 is a remedial statute which was intended to broaden the relief from joint and several liability previously available under former I.R.C. §6013(e). Section 6015 now provides three separate and distinct avenues for relief from joint and several liability on joint returns. Section 6015(b) (the new "innocent spouse" provision) contains essentially the same statutory requirements as appeared in former §6013(e), including the same knowledge limitation. However, newly enacted §6015(c) and §6015(f) provide two entirely new avenues for relief from joint and several liability that were not previously available under the old statute or any other statute. Section 6015(c) allows a divorced or separated spouse to elect to separate his or her liability from that of his or her former spouse as if they had filed separate tax returns. Section 6015(f) authorizes the Secretary of the Treasury to grant equitable relief from joint and several liability when relief is unavailable under §6015(b) and §6015(c). Specifically at issue in this petition for writ of certiorari is the proper interpretation of the separate liability election under I.R.C. §6015(c).

Internal Revenue Code §6015(c), is entitled "Procedure To Limit Liability For Taxpayers No Longer Married Or Taxpayers Legally Separated Or Not Living Together". Under §6015(c), a divorced or separated taxpayer can elect to "separate" his or her liability for items reported on a joint return from the liability of his or her ex-spouse. Separation means that the liability of each former spouse is determined as if he or she had filed separately without regard to community property law. In other words, each spouse is treated as if he or she filed a separate income tax return (without regard to community property law) and is liable for the tax on his or her own income. The fundamental principal underlying the remedy is that divorced and separated spouses should not be held liable for the taxes of their ex-spouses. Separation of liability is an entirely different concept from the traditional "innocent spouse" relief formerly contained in §6013(e) and presently contained in §6015(b). Unlike traditional "innocent spouse" relief, the separate liability election does not depend on whether or not it would be inequitable to provide relief from liability otherwise imposed upon the taxpayer. Equity is simply irrelevant.

In order to prevent ***abuse*** of the new separate liability election, Congress provided limitations on the separate liability election in §6015(c)(3)(C) and §6015(c)(4). Specifically at issue in this case is the proper interpretation of the limitation on separate liability elections imposed by §6015(c)(3)(C). Under Internal Revenue Code §6015(c)(3)(C), if the Secretary proves that an individual making a separate liability election had actual knowledge "of any item giving rise to a deficiency" which is not allocable to the individual making the election, the election shall not apply to such deficiency. This knowledge limitation on separate liability elections is entirely different than the knowledge limitation on "innocent spouse" relief. Unfortunately, the

Fifth Circuit failed to make this distinction and applied the knowledge limitation developed by the courts with respect to innocent spouse relief to interpret the knowledge limitation on separate liability elections. However, the legislative history of §6015(c) clearly reveals that Congress intended the knowledge limitation contained in I.R.C. §6015(c)(3)(C) to prevent abuse of the separate liability election by disallowing the election where the electing spouse had actual knowledge that an item on the return is reported incorrectly.

Internal Revenue Code §6015(c)(3)(C) is one of three rules from the original Senate version meant to prevent abuse of the separation of liability election. The Senate Finance Committee Report, the Conference Committee Report and the individual remarks from senators during the floor debate all uniformly demonstrate that the sole purpose of I.R.C. §6015(c)(3)(C) is to prevent taxpayers who knowingly file false returns from profiting from the separation of liability afforded by I.R.C. §6015(c).

The language of I.R.C. §6015(c)(3)(C) was introduced as an Amendment to the Senate Bill along with the another anti-abuse rule (i.e. I.R.C. §6015(d)(3)(C)). At the time of its introduction, the proponents made clear that its purpose was to prevent fraud:

> "There were concerns, and rightly so, that some taxpayers may try to abuse the innocent spouse rules by ***knowingly signing false returns***, or transferring assets for the purpose of avoiding the payment of tax, and then claim to be innocent. Obviously, no one would want to open the door to that type of ***fraud***. As such, language was included in the bill that would prevent an individual from electing the

> innocent spouse provision if they had 'actual knowledge of any item giving rise to a deficiency.'" Senator Alfonse D'Amato, Senate Floor Debate for Amendment No. 2369, 144 Cong. Rec. 56, S. 4473. (emphasis added).

Similarly, in the Senate Finance Committee Report, under "Reasons for Change," the report states:

> "The Committee is concerned that taxpayers not be allowed to abuse these rules by ***knowingly signing false returns*** or by transferring assets for the purpose of avoiding the payment of tax by the use of this election. The Committee believes that rules restricting the ability of taxpayers to limit their liability in such situations are appropriate." S. Rept. 105-174, at 55-56 (1998). (emphasis added).

The link of the rule under I.R.C. §6015(c)(3)(C) with the other anti-abuse rules is significant. These amendments were introduced together in order to prevent fraud and abuse – not to impose an additional threshold test for the ability of the taxpayer to make an election. Nowhere in the legislative history is there any indication that an additional test was to be added. Yet, this is precisely what the Fifth Circuit's interpretation of I.R.C. §6015(c)(3)(C) would do.

In addition to demonstrating the purpose of I.R.C. §6015(c)(3)(C), the legislative history also indicates the manner in which I.R.C. §6015(c)(3)(C) was to apply. In support of the amendment, Senator Graham explained that under I.R.C. §6015(c)(3)(C), "if they had actual knowledge of the conditions within that return which led to this

deficiency, then they would be 100 percent responsible." [Senate Floor Debate for Amendment No. 2369, 144 Cong. Rec. 56, S. 4473]. The Senate Finance Committee report explained that under I.R.C. §6015(c)(3)(C): "If the IRS proves that the electing spouse had ***actual knowledge that an item on a return is incorrect***, the election will not apply to such item." S. Rept. 105-174 at 59 (1998) (emphasis added). Finally, the Conference Report adopted the Finance Committee's language in explaining I.R.C. §6015(c)(3)(C): "If the IRS proves that the electing spouse had ***actual knowledge that any item on a return is incorrect***, that election will not apply to the extent any deficiency is attributable to such item." H. Conf. Rept. 105-599 at 253 (1998).

In addition to conflicting with the actual words of the Senate Finance Committee and Conference Committee reports, the Fifth Circuit's interpretation of I.R.C. §6015(c)(3)(C) actually imposes a "reason to know" standard, despite the clear language that the IRS must show "actual knowledge." It is undisputed that while Mrs. Cheshire was aware of the money stream Mr. Cheshire received, she did not actually know that the money stream was to be reported as income on their return. Thus, the knowledge that the item would give rise to a deficiency must have been imputed to her by use of some "reason to know" standard. This is unequivocally at odds with the theme of I.R.C. §6015(c), as indicated in the Senate Finance Committee and Conference Committee reports.

The legislative history of I.R.C. §6015(c)(3)(C) unequivocally supports the interpretation that actual knowledge of an item giving rise to the deficiency means actual knowledge that an item is incorrectly reported on the return. Thus, actual knowledge within the meaning of I.R.C.

§6015(c)(3)(C) should require that the taxpayer actually know that there is an error on the return. No other interpretation is consistent with Congressional intent as demonstrated in the legislative history.

In the instant case, it is undisputed that Kathryn Cheshire had no knowledge that the retirement distribution was incorrectly reported. The Tax Court expressly stated:

> "Petitioner trusted and relied upon Mr. Cheshire when it came to the preparation of their tax returns. She is an elementary school teacher, having taken no courses in accounting or tax return preparation. She asked Mr. Cheshire about the potential ramifications of the retirement distributions, and Mr. Cheshire assured petitioner that he had consulted with a certified public accountant and had been advised that the payment of the outstanding mortgage on the family residence and any amount rolled over into a qualified account reduced the taxable amount of the retirement distributions. Mrs. Cheshire had no reason to doubt the truthfulness of Mr. Cheshire's statement, and in fact believed him. Under these circumstances, we do not believe petitioner had an obligation to inquire further." (Appendix C at page 50a).

Accordingly, Kathryn Cheshire should be entitled to separate her liability from that of her ex-husband under the remedial provisions of I.R.C. section 6015(c). Had they filed separate tax returns, Kathryn Cheshire's awareness of David Cheshire's retirement distribution would make absolutely no difference. The Fifth Circuit's decision interpreting the

knowledge limitation contained in §6015(c)(3)(C) is in direct conflict with Congressional intent as demonstrated in the legislative history and will severely restrict the ability of divorced and separated spouses to separate their tax liability from that of their ex-spouse's in the future.

CONCLUSION

This is a case of significant importance involving the Fifth Circuit's interpretation of a recently enacted legislative statute which will be invoked with great frequency in the future. The Fifth Circuit has decided an important question of federal law that has not been, but should be settled by this Court. Petitioner respectfully suggests that a decision by the Court is needed in order to clarify the language and intent of this exceptionally important remedial statute. For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

JOSEPH (SIB) ABRAHAM, JR.
Counsel for KATHRYN CHESHIRE
717 E. San Antonio
3rd Floor Toltec Building
El Paso, Texas
Tel. (915) 544-7860
Fax (915) 532-4768

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 00-60855

[April 9, 2002, Filed]

KATHRYN CHESHIRE,
Petitioner - Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent - Appellee.

PETITION FOR REVIEW OF AN ORDER
OF THE INTERNAL REVENUE SERVICE (Tax Ct.)

ON PETITION FOR REHEARING EN BANC

Before KING, Chief Judge, DAVIS, Circuit Judge, and VANCE, District Judge.

(x) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. No member of the panel nor judge in regular active service of the court having requested that the court be

polled on Rehearing En Banc (Fed.R.App.P. and 5th Cir. R.35), the Petition for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/_____
United States Circuit Judge

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 00-60855

[February 8, 2002, Decided]

KATHRYN CHESHIRE,
Petitioner - Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent - Appellee.

OPINION

JUDGES:

Before KING, Chief Judge, DAVIS, Circuit Judge, and VANCE, District Judge.*

KING, Chief Judge:

* District Judge of the Eastern District of Louisiana, sitting by designation.

The Commissioner of Internal Revenue assessed a tax deficiency and associated penalties against Petitioner - Appellant Kathryn Cheshire. In the United States Tax Court, Cheshire asserted claims for innocent spouse relief from the tax deficiency and penalties under §6015(b), (c), and (f) of the Internal Revenue Code. 26 U.S.C. §6015 (Supp. 2001). The Tax Court denied Cheshire's request for innocent spouse relief, and Cheshire appeals that denial. For the following reasons, we AFFIRM the judgment of the Tax Court.

I. Factual History

The facts in this case are undisputed. Kathryn Cheshire ("Appellant") married David Cheshire in 1970. More than twenty years later, Mr. Cheshire retired from Southwestern Bell Telephone Company effective January 1, 1992, and received the following retirement distributions in 1992:

Lump sum distribution	$ 199,771
LESOP for salaried employees	5,919
Savings plan for salaried employees	23,263
ESOP	971
TOTAL	**$ 229,924**

Of the $229,924 total distribution, $42,183 was rolled over into a qualified account and is not subject to federal income tax. Mr. Cheshire deposited $184,377 of the retirement distributions into the Cheshires' joint checking

account, which earned $ 1168 in interest for 1992.[1] Appellant knew of Mr. Cheshire's receipt of $ 229,924 in retirement distributions and of the $1168 in interest earned on the distributions.

The Cheshires made several large disbursements from the retirement distributions in their joint checking account. They withdrew $99,425 from this account to pay off the mortgage on their marital residence, and they withdrew an additional $20,189 to purchase a new family car, a 1992 Ford Explorer. Mr. Cheshire also used the retirement proceeds to provide start-up capital for his new business, to satisfy loans taken out to acquire a family truck and an automobile for the Cheshires' daughter, to pay family expenses, and to establish a college fund for the Cheshires' daughter. Appellant knew of all these expenditures.

Appellant and Mr. Cheshire filed a joint federal income tax return, prepared by Mr. Cheshire, for 1992. On line 17a of this return, they reported the $199,771.05 in retirement distributions[2] but claimed only $56,150.12 of this amount as taxable. Before signing the return, Appellant questioned Mr. Cheshire about the tax consequences of the

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[1] The amounts rolled over into the qualified account ($42,183) and deposited in the joint checking account ($184,377) account for only $226,560 of the retirement distributions. The unaccounted-for remainder ($3364), although mysterious, is not significant enough to affect our analysis of the case.

[2] This number corresponds to the amount of the lump sum distribution and excludes the LESOP, ESOP, and savings plan distributions.

retirement distributions. Mr. Cheshire replied that John Daniel Mican, a certified public accountant, advised Mr. Cheshire that retirement proceeds used to pay off a mortgage are nontaxable. Appellant accepted this answer and made no further inquiries prior to signing the return on March 14, 1993. In fact, Mr. Cheshire had not consulted Mican, and all retirement proceeds that are not rolled over into a qualified account are taxable. Because of Mr. Cheshire's persistent problems with alcohol, the Cheshires permanently separated on July 13, 1993, and they divorced seventeen months later. The divorce decree awarded Appellant unencumbered title to the marital residence and to the Ford Explorer.

The Commissioner of Internal Revenue (the "Commissioner") audited the Cheshires' 1992 return and determined that Mr. Cheshire had received taxable retirement distributions of $187,741 - the difference between the total distributions ($229,924) and the rollover ($42,183). Thus, the Cheshires had understated the amount of their taxable distributions by $131,591. The Commissioner also determined that the Cheshires had underreported the interest income earned on the retirement distributions by $717. Because of these inaccuracies, the Commissioner imposed a penalty under §6662(a) of the Internal Revenue Code.[3]

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[3] Section 6662(a) provides:

> If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

II. Procedural History

Appellant commenced this action in the Tax Court. She conceded that $131,591 of the retirement distributions and the corresponding earned interest were improperly excluded from taxable income. She claimed, however, that she was entitled to relief as an innocent spouse under §6015(b),[4]

---

26 U.S.C. §6662 (a) (Supp. 2001).

[4] Section 6015(b)(1) provides:

> If-
> (A) a joint return has been made for a taxable year;
> (B) on such return there is an understatement of tax attributable to erroneous items of one individual filing the joint return;
> (C) the other individual filing the joint return establishes that in signing the return he or she did not know, and had no reason to know, that there was such understatement;
> (D) taking into account all the facts and circumstances, it is inequitable to hold the other individual liable for the deficiency in tax for such taxable year attributable to such understatement; and
> (E) the other individual elects ... the benefits of this subsection not later than the date which is 2 years after the date the Secretary has begun collection activities with respect to the individual making the election,

§6015(c),[5] or §6015(f)[6] of the Internal Revenue

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then the other individual shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such understatement.

26 U.S.C. §6015 (b)(1) (Supp. 2001).

[5] Section 6015(c)(1) provides:

If an individual who has made a joint return for any taxable year elects the application of this subsection, the individual's liability for any deficiency which is assessed with respect to the return shall not exceed the portion of such deficiency properly allocable to the individual under subsection (d).

26 U.S.C. §6015 (c)(1) (Supp. 2001). The general rule under subsection (d) is that:

Any item giving rise to a deficiency on a joint return shall be allocated to individuals filing the return in the same manner as it would have been allocated if the individuals had filed separate returns for the taxable year.

26 U.S.C. §6015 (d)(3)(A) (Supp. 2001).

[6] Section 6015(f) provides:

If-
(1) taking into account all the facts and circumstances, it is inequitable to hold the

Code. 26 U.S.C. §6015. Prior to trial, the Commissioner conceded that Appellant qualified for innocent spouse relief with respect to the LESOP distribution ($ 5919), the savings plan distribution ($23,262), and the ESOP distribution ($ 971). Consequently, the taxable income from the retirement distributions and the corresponding earned interest remaining in dispute totaled $ 101,438 and $691, respectively. These amounts roughly correspond to the improperly deducted amounts that the Cheshires used to pay off their mortgage.

The Tax Court majority, consisting of twelve judges, denied Appellant relief under §6015(b), (c), and (f). *Cheshire v. Comm'r,* 115 T.C. 183 (2000). The Tax Court found that Appellant failed to establish that she "did not know, and had no reason to know" of the tax understatement as required for relief under § 6015(b)(1)(C). *Id.* at 193. The Tax Court also found that Appellant was not entitled to relief under § 6015(c) because she had "actual knowledge ... of any item giving rise to a deficiency" within the meaning of §6015(c)(3)(C).[7] *Id.* at

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individual liable for any unpaid tax or any deficiency (or any portion of either); and

(2) relief is not available to such individual under subsection (b) or (c),

the Secretary may relieve such individual of such liability.

26 U.S.C. § 6015 (f) (Supp. 2001).

[7] Section 6015(c)(3)(C) provides:

197. Finally, the Tax Court held that the Commissioner did not abuse his discretion in denying Appellant equitable relief under §6015(f) with respect to the retirement distributions and the interest income, as well as the §6662(a) penalty associated with the interest income.[8] *Id.* at 198.

III. The Statutory Scheme

Generally, spouses who choose to file a joint return are subject to joint and several liability for tax deficiencies under the Internal Revenue Code. 26 U.S.C. §6013 (d)(3) (Supp. 2001). Recognizing that joint and several liability may be unjust in certain circumstances, Congress authorized relief from such liability under the "innocent spouse" provision, 26 U.S.C. §6015. Section 6015 provides three distinct types of relief for taxpayers who file joint returns.[9] First, §6015(b)

> If the Secretary demonstrates that an individual making an election under this subsection had actual knowledge, at the time such individual signed the return, of any item giving rise to a deficiency (or portion thereof) which is not allocable to such individual under subsection (d), such election shall not apply to such deficiency (or portion).
>
> 26 U.S.C. §6015 (c)(3)(C) (Supp. 2001).

[8] The Tax Court granted Appellant equitable relief with respect to the portion of the §6662(a) penalty associated with the retirement distributions, however. *Id.* at 198-99.

[9] Relief under the former innocent spouse statute, §6013(e), was difficult to obtain, so Congress repealed § 6013(e) and enacted a new provision, §6015, in 1998. See S. REP. NO.

provides relief for all joint filers who satisfy the five requirements listed in that section.[10] Second, §6015(c) allows a spouse who filed a joint tax return to elect to limit her income tax liability for that year to her separate liability amount.[11] Section 6015(c) applies only to taxpayers who are no longer married, are legally separated, or do not reside together over a twelve-month period. 26 U.S.C. §6015 (c)(3)(A)(i). Furthermore, a spouse who had actual knowledge of an item giving rise to a deficiency at the time that spouse signed the return may not seek relief under §6015(c). 26 U.S.C. §6015 (c)(3)(C).[12]

Finally, a taxpayer may seek relief as an "innocent spouse" under §6015(f), which authorizes the Secretary of the Treasury (the "Secretary") or his delegate to grant equitable relief from joint and several liability when relief is unavailable under §6015(b) and (c).[13] Except for the knowledge

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105-174, at 55 (1998); H.R. REP. NO. 105-364(I), at 61 (1998). New §6015(b)(1) provides similar relief to that available under former §6013(e). New §6015(c) and (f), however, are new forms of relief.

[10] See supra note 4 for complete text of 26 U.S.C. §6015 (b)(1).

[11] See supra note 5 for complete text of 26 U.S.C. 6015 (c)(1).

[12] See supra note 7 for complete text of 26 U.S.C. 6015 (c)(3)(C).

[13] See supra note 6 for complete text of 26 U.S.C. 6015 (f).

requirement of §6015(c)(3)(C) (the provision disallowing election of separate liability to a spouse with actual knowledge of the item giving rise to the deficiency), the taxpayer bears the burden of proving that she has met all the prerequisites for innocent spouse relief. See *Reser v. Comm'r,* 112 F.3d 1258, 1262-63 (5th Cir. 1997). Section 6015(c)(3)(C) explicitly places the burden of proof on the Secretary.

IV. Standard of Review

This court reviews decisions of the Tax Court "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." 26 U.S.C. §7482 (a)(1) (1989 & Supp. 2001). Thus, we review issues of law de novo and findings of fact for clear error. *Park v. Comm'r,* 25 F.3d 1289, 1291 (5th Cir. 1994). The Tax Court's determination that a spouse is not entitled to innocent spouse relief is a finding of fact that this court reviews for clear error. *Reser*, 112 F.3d at 1262.

V. Section 6015(b) Relief

Section 6015(b)(1) provides innocent spouse relief if the taxpayer satisfies all of the five requirements listed in that section.[14] In this case, the parties concede that Appellant satisfied the requirements of subsections (A), (B), and (E) of §6015(b)(1). Thus, the §6015(b) issue presented by this case is whether Appellant satisfied the requirements of subsections (C) and (D). We conclude that Appellant has not satisfied the

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[14] See supra note 4 for complete text of 26 U.S.C. 6015 (b)(1).

requirement of subsection (C) and thus is not entitled to relief under §6015(b).

Subsection (C) allows for innocent spouse relief only if the spouse "establishes that in signing the return he or she did not know, and had no reason to know, that there was such understatement."[15] 26 U.S.C. §6015 (b)(1)(C). Originally, the innocent spouse provision (formerly codified at §6013(e)(1)) granted relief only in cases involving omitted income, i.e., cases in which the tax return failed to report taxable income. Since the enactment of the original provision, courts have agreed that in omitted income cases, the spouse's actual knowledge of the underlying transaction that produced the income is sufficient to preclude innocent spouse relief (the "knowledge-of-the-transaction test"). *Reser,* 112 F.3d at 1265.[16] In 1984, the innocent spouse provision was expanded to include relief in erroneous deduction cases, i.e., cases in which an incorrect deduction results in an understatement of taxable income. *Park,* 25 F.3d at 1292. The Tax Court applies

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[15] Because current subsection (C) of §6015(b)(1) is virtually identical to former subsection (C) of §6013(e)(1), we may look to cases construing §6013(e)(1)(C) for help in construing § 6015(b)(1)(C). See *Butler v. Comm'r,* 114 T.C. 276, 283 (2000).

[16] The knowledge-of-the-transaction test conflicts with the plain meaning of §6015(b)(1)(C), which limits relief to spouses with no knowledge of the understatement. Along with other courts, this court has concluded that this deviation from plain meaning is justified because it avoids "acceptance of an ignorance of the law defense." *Sanders v. United States,* 509 F.2d 162, 169 n.14 (5th Cir. 1975); see also *Price v. Comm'r,* 887 F.2d 959, 963 n.9 (9th Cir. 1989).

the knowledge-of-the-transaction test to both types of cases, see *Bokum v. Comm'r,* 94 T.C. 126, 151 (1990), though some circuits have adopted an alternate test for erroneous deduction cases.[17] See, e.g., *Price v. Comm'r,* 887 F.2d 959, 965 (9th Cir. 1989); *Reser,* 112 F.3d at 1267 (Fifth Circuit case).

The Ninth Circuit was the first circuit to adopt an alternative knowledge test for erroneous deduction cases. In Price, the Ninth Circuit established that a spouse fails to satisfy the §6015(b)(1)(C) knowledge requirement in erroneous deduction cases if "a reasonably prudent taxpayer in her position at the time she signed the return could be expected to know that the return contained the substantial understatement." 887 F.2d at 965. The Ninth Circuit reasoned that since erroneous deductions are necessarily reported on a tax return, any spouse who signs the joint return is thereby put on notice that an income-producing transaction occurred. *Id.* at 963 n.9. Thus, in erroneous deduction cases, it would be illogical to bar recovery for spouses with mere knowledge of the transaction as this would preclude any spouse from obtaining relief under §6015(b). Id. The Ninth Circuit noted that "adoption of such an interpretation would do violence to the intent Congress clearly expressed when it expanded coverage of the provision to include relief for spouses from

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[17] The Tax Court has suggested that if the case is appealable to a circuit that has adopted a different knowledge test for erroneous deduction cases, it will apply that circuit's knowledge test rather than the knowledge-of-the-transaction test. See *Bokum,* 94 T.C. at 151 (declining to follow the Ninth Circuit's knowledge standard in erroneous deduction cases "except in those instances where appeal lies to that Court of Appeals").

deficiencies caused by deductions for which there is no basis in fact or law." *Id.*

Thus, under the Price approach, actual knowledge of the underlying transaction, standing alone, is not enough to preclude innocent spouse relief under §6015(b)(1)(C) in erroneous deduction cases. However, Price notes that if the spouse knows "virtually all of the facts pertaining to the transaction which underlies the substantial understatement," then her defense "is premised solely on ignorance of law," and "she is considered as a matter of law to have reason to know of the substantial understatement." *Id.* at 964 (emphasis added).

This court adopted the Price approach and reasoning in Reser. [18] See 112 F.3d at 1267. Accordingly, in erroneous deduction cases, this court questions whether the spouse "knew or had reason to know that the deduction in question would give rise to a substantial understatement of tax on the joint return." *Id.* (emphasis in original). However, if the spouse knows enough about the underlying transaction that her innocent spouse defense rests entirely upon a mistake of law, she has "reason to know" of the tax understatement as a matter of law. See *Park,* 25 F.3d at 1293-94 (noting that ignorance of the law cannot establish an innocent spouse defense to tax liability); *Sanders v. United States,* 509 F.2d

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[18] The Second, Seventh, Eighth, and Eleventh Circuits have also followed the Ninth Circuit's decision in Price. See *Resser v. Comm'r,* 74 F.3d 1528, 1535-36 (7th Cir. 1996); *Bliss v. Comm'r,* 59 F.3d 374, 378 n.1 (2d Cir. 1995); *Kistner v. Comm'r,* 18 F.3d 1521, 1527 (11th Cir. 1994); *Erdahl v. Comm'r,* 930 F.2d 585, 589 (8th Cir. 1991).

162, 169 & n.14 (5th Cir. 1975). If "reason to know" cannot be determined as a matter of law, the proper factual inquiry is "whether a reasonably prudent taxpayer in the spouse's position at the time she signed the return could be expected to know that the stated liability was erroneous or that further investigation was warranted." *Reser,* 112 F.3d at 1267.

In this case, the Cheshires reported the receipt of $199,771.05 in retirement distributions on line 17a of their joint tax return. On line 17b, they reported $56,150.12 as the taxable amount of those retirement distributions. Mr. Cheshire led Appellant to believe that he calculated this amount of taxable income by properly deducting the money placed in a qualified account ($42,183) and the money used to pay off the mortgage on their home ($99,425). In fact, only the money placed in a qualified account was properly excludable from the Cheshires' taxable income. Appellant argues that these facts present a case of erroneous deduction and that the knowledge-of-the-incorrect-deduction standard is therefore applicable. The Commissioner argues that this is a case of omitted income and that the knowledge-of-the-transaction test is therefore applicable.

This court has not previously determined if such facts present a case of omitted income or of erroneous deduction, and we need not do so here because the outcome under either standard is the same: Appellant knew or had reason to know of the tax understatement.[19] Under the knowledge-of-the-

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[19] This court took the same approach in Park. See *Park,* 25 F.3d at 1298-99. Because the result in Park was the same under the knowledge-of-the-transaction test and the new erroneous deduction test set forth in the Ninth Circuit's opinion in Price, this

transaction test applied in omitted income cases, Appellant fails to satisfy §6015(b)(1)(C) because she had actual knowledge of the retirement distributions and of the corresponding earned interest at the time she signed the return.[20] In erroneous deduction cases, this court asks whether Appellant "knew or had reason to know" that the deduction in question would give rise to a tax understatement at the time she signed the return. The parties agree that Appellant did not have actual knowledge that the deduction was improper. However, because Appellant knew all the facts surrounding the transaction that gave rise to the understatement, including the amount of the retirement proceeds, the account where the proceeds were deposited and drawn upon, the amount of interest earned on the proceeds, and the manner in which the proceeds were spent, Appellant had "reason to know" of the improper deduction as a matter of law. Appellant's defense consists only of her mistaken belief that money spent to pay off a mortgage is properly deductible from retirement distributions. Ignorance of the law cannot establish an innocent spouse defense to tax liability. *Park,* 25 F.3d at 1293-94; *Sanders,* 509 F.2d at 169 & n.14.

Because Appellant "knew or had reason to know" of the understatement under both the omitted income standard and the erroneous deduction standard, she fails to establish the requirement of §6015(b)(1)(C). This conclusion bars relief under §6015(b)(1), obviating the need for this court to decide whether Appellant satisfied the requirement of

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court declined to determine which test applied. *Id.*

[20] This is the result reached by the Tax Court. *Cheshire,* 115 T.C. at 193.

§6015(b)(1)(D). The Tax Court's determination that Appellant is not entitled to innocent spouse relief under §6015(b)(1) is not clearly erroneous.

VI. Section 6015(c) Relief

Section 6015(c)(1) allows any divorced (or separated) individual to elect to assume responsibility for only that portion of a joint tax deficiency that is properly allocable to that individual.[21] The parties agree that Appellant falls within the class of taxpayers permitted to make a §6015(c) election since she and Mr. Cheshire were divorced when she filed her petition with the Tax Court. Moreover, neither party in this case disputes that the deficiency attributable to the retirement distributions is properly allocable to Mr. Cheshire. Thus, if this election is available to Appellant, she can avoid liability for the tax deficiency caused by the retirement distributions. However, the benefit of the §6015(c) election is not available to an individual with actual knowledge of "any item giving rise to a deficiency." 26 U.S.C. §6015 (c)(3)(C).[22] In order to preclude relief under §6015(c), the Commissioner must prove by a preponderance of the evidence that Appellant had actual knowledge of "any item giving rise to a deficiency." *Culver v. Comm'r,* 116 T.C. 189, 196 (2001). Whether the Commissioner satisfied this burden is the §6015(c) issue in this appeal.

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[21] See supra note 5 for complete text of 26 U.S.C. 6015 (c)(1).

[22] See supra note 7 for complete text of 26 U.S.C. 6015 (c)(3)(C).

The debate between the parties focuses on the meaning of the term "item" in § 6015(c)(3)(C). Appellant argues that "item" means "incorrect tax reporting of an item of income, deduction, or credit" so that § 6015(c)(3)(C) only bars relief for spouses with actual knowledge that an entry on the joint tax return is incorrect. The Commissioner argues that "item" means "an item of income, deduction, or credit" so that § 6015(c)(3)(C) bars relief for all spouses with actual knowledge of the income-producing transaction, even if they lacked knowledge of the incorrect tax reporting of that transaction.

The term "item" appears fifteen times in §6015. Most of these appearances are uninformative, but the uses of the term "item" in §6015(b)(1)(B) and (d)(4) support the Commissioner's definition. Section 6015(b)(1)(B) refers to "an understatement of tax attributable to erroneous items of one individual filing the joint return."[23] If "item" refers to the "incorrect tax reporting of an item," as Appellant asserts, then the reference to an "erroneous item" is redundant. Thus, §6015(b)(1)(B) suggests that "item" means "an item of income, deduction, or credit," as the Commissioner asserts. Furthermore, §6015(d)(4) refers to "an item of deduction or credit."[24] This use of the term "item" suggests that the term

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[23] See supra note 4 for the complete text of 26 U.S.C. §6015 (b)(1).

[24] Section 6015(d)(4) provides:

> If an item of deduction or credit is disallowed in its entirety solely because a separate return is filed, such disallowance shall be disregarded and the item

refers to an actual item of income, deduction, or credit, rather than the incorrect reporting of such an item.

26 U.S.C. § 6015 (d)(4) (Supp. 2001).

Other sections of the Internal Revenue Code define the term "item" without reference to tax consequences. For example, §61(a) defines "gross income" to include such "items" as compensation for services, interest, rents, and royalties. 26 U.S.C. §61 (a) (1988 & Supp. 2001). Thus, in this context, "item" means an item of income. Section 6231(a)(3) defines the term "partnership item" as "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A ...." 26 U.S.C. §6231 (a)(3) (1989 & Supp. 2001). These uses of the term "item," as well as those uses appearing in § 6015, suggest that "item" means "an item of income, deduction, or credit." See *Comm'r v. Lundy, 516 U.S. 235, 250, 116 S. Ct. 647, 133 L. Ed. 2d 611 (1996)* (stating that "identical words used in different parts of the same act are intended to have the same meaning") (internal citations and quotations omitted). This interpretation supports the Commissioner's position that §6015(c)(3)(C) bars relief for all spouses with actual knowledge of the income-producing transaction, even if they lacked knowledge of the incorrect tax reporting of that transaction.

Furthermore, Appellant's claim that §6015(c)(3)(C) precludes relief only if the spouse has knowledge of incorrect

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> shall be computed as if a joint return had been filed and then allocated between the spouses appropriately. A similar rule shall apply for purposes of section 86.

tax reporting runs afoul of the general rule that ignorance of the tax laws is not a defense to a tax deficiency. See *Park,* 25 F.3d at 1293-94 (noting that ignorance of the law cannot establish an innocent spouse defense to tax liability). In Sanders, a case applying the predecessor innocent spouse statute, we noted that the statute "seemingly makes ignorance of the fact that known receipts constitute taxable income a valid justification for not knowing or having reason to know of omissions from gross income." 509 F.2d at 169 n.14. Rather than establish an ignorance of the law defense, however, in Sanders we decided to apply a statutory interpretation that "is difficult to square with a literal reading of the statutory language" because "the practical problems that have always prevented acceptance of an ignorance of the law defense in the criminal law area ... arguably apply just as forcefully here." Id. Unlike the court in Sanders, we need not overlook the literal meaning of the statute at issue in this case. As the above discussion illustrates, the plain meaning of §6015(c)(3)(C) suggests that a spouse with actual knowledge of the income-producing transaction cannot receive innocent spouse relief even if she lacks knowledge of the incorrect tax reporting of that transaction. This reading of the plain meaning of §6015(c)(3)(C) is compelling in light of the general principle that ignorance of the law is not a defense.

To support the theory that "item" means "incorrect tax reporting of an item," Appellant and amici curiae point to the legislative history of §6015(c)(3)(C). We decline to defer to this legislative history for two reasons. First, when interpreting a statute, this court "must presume that a legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank v. Germain,* 503 U.S. 249, 253-54, 117 L. Ed. 2d 391, 112 S. Ct. 1146

(1992). Unless the text of a statute is ambiguous on its face, this court adheres to that statute's plain meaning. Id. As the above analysis demonstrates, the text of §6015 and other sections of the Internal Revenue Code strongly suggests that "item" refers to "an item of income, deduction, or credit." Section 6015(c)(3)(C) is not facially ambiguous.

Second, the legislative history of §6015(c)(3)(C) is ambiguous. Some portions of the history appear to support the Commissioner's position. See S. REP. NO. 105-174, at 55-56, 59; H.R. CONF. REP. NO. 105-599, at 253 (1998); 144 CONG. REC. 56, S4473 (1998). Other parts of the history, however, suggest that the §6015(c)(3)(C) exception is intended to cover spouses with knowledge of the transaction giving rise to the deficiency in addition to spouses with knowledge that the tax return is incorrect. See H.R. CONF. REP. NO. 105-599, at 253; S. REP. NO. 105-174, at 58. We decline to allow inconclusive legislative history to affect our interpretation of the plain meaning of §6015(c)(3)(C). See *Hubbard v. United States,* 514 U.S. 695, 708, 131 L. Ed. 2d 779, 115 S. Ct. 1754 (1995) (noting that "courts should not rely on inconclusive statutory history as a basis for refusing to give effect to the plain language of an Act of Congress"). Thus, we conclude that "item" means "an item of income, deduction, or credit," as asserted by the Commissioner.[25]

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[25] This determination is in line with an unpublished Ninth Circuit opinion holding that the taxpayer's "actual knowledge of items of income that were unreported" precluded relief under §6015(c) even though the taxpayer had no knowledge that the tax return was incorrect. *Wiksell v. Comm'r,* 2000 U.S. App. LEXIS 5857, No. 99-70643, 2000 WL 340130, at *2 (9th Cir. Mar. 28, 2000) (unpublished).

The Tax Court adopted this definition of "item" and indicated that the knowledge standard under §6015(c)(3)(C) in an omitted income case is "actual and clear awareness" of an item of income.[26] *Cheshire,* 115 T.C. at 195. Since Cheshire, the Tax Court has interpreted the knowledge standard in the context of an erroneous deduction to be "actual knowledge of the factual circumstances which made the item unallowable as a deduction." *King v. Comm'r,* 116 T.C. 198, 204 (2001). As Appellant is liable under either standard, we need not determine which standard applies in this case. Appellant had "actual and clear awareness" of Mr. Cheshire's retirement distributions and earned interest. Thus, she satisfies the §6015(c)(3)(C) knowledge requirement for omitted income cases. Furthermore, Appellant was aware of how the retirement distributions were spent. None of these expenditures qualifies for proper deduction, so Appellant had "actual knowledge of the factual circumstances which made the item unallowable as a deduction." In such circumstances, Appellant satisfies the §6015(c)(3)(C) knowledge requirement for erroneous deduction cases. Thus, §6015(c)(3)(C) bars relief under either the omitted income or the erroneous deduction knowledge standard, even though Appellant was

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[26] Contrary to Appellant's contention, the Tax Court's interpretation of §6015(c) does not ignore its remedial nature by improperly substituting the knowledge requirement from §6015(b)(1)(C) (and former §6013(e)(1)(C)) for the stricter knowledge requirement of §6015(c)(3)(C). The knowledge standard of §6015(c)(3)(C) requires "actual knowledge." The Tax Court interpreted this to mean "actual and clear awareness ... of the existence of an item." *Cheshire,* 115 T.C. at 195. Unlike former §6013(e)(1)(C) and current 6015(b)(1)(C), a mere "reason to know" is not enough to preclude tax relief under §6015(c).

unaware of the tax consequences of the deduction. The Tax Court's determination that Appellant is not entitled to innocent spouse relief under §6015(c) is not clearly erroneous.

VII. Section 6015(f) Relief

Section 6015(f) confers power upon the Secretary and his delegate, the Commissioner, to grant equitable relief where a taxpayer is not entitled to relief under §6015(b) or (c), but "taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency (or any portion of either)."[27] In this case, Appellant argues that the Commissioner improperly denied her equitable relief with respect to the retirement distributions and the interest income.[28] This court reviews the Commissioner's decision to deny equitable relief for abuse of discretion. See *Butler,* 114 T.C. at 291-92.[29]

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[27] See supra note 6 for complete text of 26 U.S.C. 6015 (f).

[28] The Commissioner also denied Appellant equitable relief with respect to the entire §6662(a) accuracy-related penalty. The Tax Court affirmed the denial of equitable relief with respect to the §6662(a) penalty associated with the interest income. *Cheshire,* 115 T.C. at 198-99. However, the Tax Court granted equitable relief to Appellant for the portion of the §6662(a) penalty that relates to the retirement distributions. Id. Neither party appeals these findings.

[29] Because the wording of §6015(f)(1) is virtually identical to that of former §6013(e)(1)(D), case law construing former §6013(e)(1)(D) is helpful in determining whether the Commissioner abused his discretion in denying equitable relief to

This court has stated that "the most important factor in determining inequity is whether the spouse seeking relief 'significantly benefitted' from the understatement of tax." *Reser,* 112 F.3d at 1270 (quoting *Buchine v. Comm'r,* 20 F.3d 173, 181 (5th Cir. 1994)). This benefit can be indirect, such as "a spouse's receipt of more than she otherwise would as part of a divorce settlement." *Reser,* 112 F.3d at 1270. In the instant case, Appellant received as part of the divorce settlement the Cheshires' marital residence, the value of which was enhanced by the use of $99,425 in untaxed retirement distributions to pay off the mortgage. Appellant also received the family car, which was purchased with retirement distributions. The Commissioner could have reasonably concluded upon these facts that Appellant received significant benefit from the tax understatement. Thus, the Commissioner's decision to deny equitable relief to Appellant is sufficiently supported and not an abuse of discretion. Accordingly, the Tax Court correctly determined that the Commissioner did not abuse his discretion when he denied equitable relief to Appellant under §6015(f) with respect to the retirement distributions and the interest income.

VIII. CONCLUSION

For all the foregoing reasons, we AFFIRM the judgment of the Tax Court.

Appellant under current §6015(f)(1). See *Butler,* 114 T.C. at 291 (applying the §6013(e)(1)(D) standard to a §6015(f) inquiry because "the language of section 6015(f)(1) does not differ significantly from the language of former section 6013(e)(1)(D)").

APPENDIX C

UNITED STATES TAX COURT

No. 3483-99

August 30, 2000, Filed

KATHRYN CHESHIRE, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent .

DISPOSITION:

PARR, GALE, and MARVEL, JJ., agree with this dissenting opinion.

JUDGES:

Jacobs, Julian I., opinion;
Thornton, Michael B., concurring opinion;
Parr, Carolyn Miller, dissenting opinion;
Colvin, John O., dissenting opinion

OPINION BY:

JACOBS; WELLS; CHIECHI; THORNTON; WHALEN; PARR; COLVIN; PARR

OPINION

Respondent determined a $66,069 deficiency in Kathryn and David Cheshire's 1992 Federal income tax, a $16,518 section 6651(a)(1) addition to tax, and a $13,214 section 6662(a) accuracy-related penalty. Only Kathryn Cheshire has contested this determination; she does so claiming innocent spouse relief under section 6015(b), (c), and/or (f).

After concessions by respondent, see infra, the issue to be resolved is whether Mrs. Cheshire is entitled to innocent spouse relief with respect to: (1) The taxation of an omitted portion of the distributions Mr. Cheshire received upon his retirement from Southwestern Bell Telephone Co., and omitted interest income from a joint bank account, and (2) the section 6662(a) accuracy-related penalty.

All section references are to the Internal Revenue Code as in effect for the year under consideration. All Rule references are to the Tax Court Rules of Practice and Procedure. All dollar amounts are rounded.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and the attached exhibits are incorporated herein by this reference.

BACKGROUND

Petitioner resided in Cedar Creek, Texas, at the time she filed her petition.

Petitioner and Mr. Cheshire were married on June 20, 1970; they permanently separated on July 13, 1993, and were divorced on December 5, 1994. For 1992, petitioner and Mr. Cheshire (collectively, the Cheshires) filed a joint Federal income tax return.

Petitioner received a bachelor of science degree in secondary education. Upon graduating from college in 1970, she worked approximately 3 years as an elementary school teacher, then stayed home for approximately 10 years (1974-84) in order to raise her 2 children. She returned to teaching in 1984.

In September 1985, the Cheshires purchased property located at 24A Simpson Avenue, Cedar Creek, Texas, for use as the family residence. The Cheshires borrowed $99,000 to purchase the property.

DAVID CHESHIRE'S RETIREMENT AND COMPENSATION PACKAGE

Mr. Cheshire took early retirement from Southwestern Bell Telephone Co. (Southwestern Bell), effective January 1, 1992. As a result, Mr. Cheshire received the following distributions (the retirement distributions) in 1992:

	Amount
Nations Bank of Texas, Trustee, for "SBNCNPP EMP LUMP SUM"	$199,771
Southwestern Bell LESOP for salaried employees	5,919
Southwestern Bell savings plan for salaried employees	23,263
Southwestern Bell ESOP	971
Total	229,924

Of the $229,924, $42,183 was rolled over into a qualified account.

On January 31, 1992, Mr. Cheshire deposited $184,377 of the retirement distributions into an account (account No. 9633-09) in the name of "David D. Cheshire and Kathy Cheshire" at the Austin Telco Federal Credit Union (the Austin Telco account).[1] In 1992, the funds in this account earned $ 1,168 in interest.

Petitioner was aware of Mr. Cheshire's receipt of the retirement distributions and the amount thereof, as well as the interest earned on the Austin Telco account.

THE CHESHIRES' USE OF THE RETIREMENT DISTRIBUTIONS

The Cheshires made several large disbursements out of the Austin Telco account in 1992. Specifically, $99,425 was withdrawn to pay off the mortgage on the family residence, and $20,189 was withdrawn to purchase a 1992 Ford Explorer.

The retirement distributions were also used to pay family expenses, provide startup capital for Mr. Cheshire's newly formed sole proprietorship, Academic Resources

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[1] An additional $29,786 was deposited into this account between Jan. 29 and Feb. 4, 1992. The record does not reveal the source of these funds.

Management Systems (ARMS), and for investments.[2] In addition, the retirement distributions were used to satisfy loans taken out to acquire a family truck and a car for one of their children as well as to open a college bank account for their daughter. The Cheshires retained joint ownership of this account.

On September 22, 1992, Mr. Cheshire opened a second account (account No. 25239-87) at the Austin Telco Federal Credit Union and transferred the remaining proceeds of the retirement distributions from account No. 9633-09 into this account. On November 12, 1992, Mr. Cheshire wrote a check from this second account in the amount of $6,300 payable to "A.R.M.S."; this amount was subsequently deposited into ARMS' bank account. In 1992, the funds in account No. 25239-87 earned $26 in interest.

PETITIONER'S SEPARATION AND DIVORCE

Mr. Cheshire was arrested several times for driving while intoxicated (DWI). In June 1993, he was involved in an alcohol- related automobile accident. Approximately a month later, petitioner and Mr. Cheshire permanently separated; they divorced 17 months after their separation.

Pursuant to a divorce decree, Mr. Cheshire transferred to petitioner his interest in the property constituting the family residence and title to the 1992 Ford Explorer. At the time of

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[2] On Apr. 24 and May 19, 1992, Mr. Cheshire deposited $40,000 and $5,301, respectively, into a brokerage account at Edward D. Jones & Co.

transfer, the family residence and the Ford Explorer were unencumbered.

THE CHESHIRES' 1992 FEDERAL INCOME TAX RETURN

Mr. Cheshire prepared and filed his and Mrs. Cheshire's joint income tax returns. Mr. Cheshire prepared the Cheshires' 1992 joint Federal income tax return (the 1992 return) in March 1993, prior to beginning a jail sentence for a DWI conviction. Before signing the return, petitioner questioned her husband about the potential tax ramifications of the retirement distributions. Mr. Cheshire falsely told petitioner he had consulted with a local certified public accountant, J.D. Mican (Mr. Mican), and had been advised that proceeds used to pay off the mortgage on their home would reduce the taxable amount of the retirement distributions. Accepting her husband's answer, petitioner did not inquire further and signed the 1992 return on March 14, 1993. Petitioner assumed that the 1992 return would be timely filed. On the 1992 return, the Cheshires reported that they had received a $199,771 retirement distribution and that $56,150 of that amount constituted taxable income. In addition, they reported $ 477 in interest income, as well as a $12,349 loss on their Schedule C, Profit or Loss From Business.

In August 1994, petitioner received a letter from the Internal Revenue Service (IRS) stating that it had not received the Cheshires' 1992 return. In searching for a copy of the 1992 return, petitioner discovered in a desk drawer the original 1992 return as well as a check for the amount of tax shown to be owing ($23.86). Petitioner immediately contacted

Mr. Mican; he advised her to file the 1992 return and enclose payment for the tax liability reflected on the return as soon as possible. Petitioner filed the 1992 return along with the remittance on August 15, 1994.

In early October 1994, petitioner received notification from the IRS that $8,502 in estimated tax payments claimed on the Cheshires' 1992 return had not been paid. Despite Mr. Cheshire's reassurance that he had made the estimated tax payments, petitioner discovered that the payments in fact had not been made. Upon the advice of Mr. Mican, petitioner paid the estimated tax using borrowed funds.

NOTICE OF DEFICIENCY

Respondent determined that $187,741 of the retirement distributions ($229,924 total distributions less the $42,183 rollover) constituted taxable income, and thus the Cheshires understated the taxable amount of the retirement distributions by $131,591 ($187,741 - $56,150). Respondent further determined that the Cheshires understated (1) their interest income by $717, (2) their dividend income and capital gains by $132 and $1,889, respectively, and (3) their self-employment tax by $353. In addition, respondent disallowed $14,843 in Schedule C expenses. As a result of these determinations, as well as the late filing of the 1992 return, respondent determined that a section 6651(a)(1) addition to tax and a section 6662(a) accuracy-related penalty should be imposed.

RESPONDENT'S CONCESSIONS

Prior to trial, respondent conceded that petitioner qualified for innocent spouse relief with respect to the following:

Item	Amount
Schedule C expenses	$ 14,843
Self-employment taxes	353
Capital gains	1,889
Dividend income	132
Interest income	26
Southwestern Bell LESOP distribution	5,919
Southwestern Bell savings plan distribution	23,263
Southwestern Bell ESOP distribution	971
Section 6651(a)(1) addition to tax	16,518

OPINION

As a general proposition, if a joint return is filed by a husband and wife, liability with respect to any tax shown on the return or found to be owing is joint and several. See sec. 6013(d)(3). In 1971, Congress enacted section 6013(e), the predecessor to section 6015, in order to correct perceived grave injustices often resulting from the imposition of joint and several liability. See S. Rept. 91-1537, at 2 (1970), *1971-1 C.B. 606, 607;* see also Act of Jan. 12, 1971, Pub. L. 91-679, sec. 1, 84 Stat. 2063 (enacted sec. 6013(e)), as amended by the Deficit Reduction Act of 1984, Pub. L. 98-369, sec. 424, 98 Stat. 494, 801-803.

As amended,[3] section 6013(e) provided that a spouse could be relieved of tax liability if the spouse proved: (1) A joint income tax return was filed; (2) the return contained a substantial understatement of tax attributable to grossly erroneous items of the other spouse; (3) in signing the return, the spouse seeking relief did not know, and had no reason to know, of the substantial understatement; and (4) under the circumstances it would be inequitable to hold the spouse seeking relief liable for the substantial understatement. The relief granted under section 6013(e) is commonly referred to as innocent spouse relief.

THE ENACTMENT OF SECTION 6015

For many taxpayers, relief under section 6013(e) was difficult to obtain. In order to make innocent spouse relief more accessible, Congress repealed section 6013(e) and enacted a new innocent spouse provision (section 6015) in 1998 as part of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Pub. L. 105-206, sec. 3201(a), 112 Stat. 734. See H. Conf. Rept. 105-599, at 249 (1998). The newly enacted statute provided three avenues of relief from joint and several liability: (1) Section 6015(b)(1) (which is similar to former section 6013(e)) allows a spouse to escape completely joint and several liability; (2) section 6015(b)(2) and (c) allow a spouse to elect limited liability

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[3] Initially, sec. 6013(e) provided relief only in cases involving an omission of income. In 1984, the scope of sec. 6013(e) was expanded to provide relief in erroneous deduction cases. See Deficit Reduction Act of 1984, Pub. L. 98-369, sec. 424, 98 Stat. 494, 801-803; H. Conf. Rept. 98-861, at 1119 (1984), 1984-3 C.B. (Vol. 2) 1, 373.

through relief from a portion of the understatement or deficiency; and (3) section 6015(f) confers upon the Secretary discretion to grant equitable relief in situations where relief is unavailable under section 6015(b) or (c). Section 6015 generally applies to any liability for tax arising after July 22, 1998, and any liability for tax arising on or before July 22, 1998, that remains unpaid as of such date. See H. Conf. Rept. 105-599, at 251 (1998).

APPLICABLE STATUTORY PROVISIONS

Section 6015(b) provides:

> SEC. 6015(b). Procedures for Relief From Liability Applicable to All Joint Filers. --
>
> > (1) In general. -- Under procedures prescribed by the Secretary, if --
> >
> > > (A) a joint return has been made for a taxable year;
> > >
> > > (B) on such return there is an understatement of tax attributable to erroneous items of 1 individual filing the joint return;
> > >
> > > (C) the other individual filing the joint return establishes that in signing the return he or she did not know, and had no reason to know, that there was such understatement;
> > >
> > > (D) taking into account all the facts and circumstances, it is inequitable to hold the

> other individual liable for the deficiency in tax for such taxable year attributable to such understatement; and
>
> (E) the other individual elects (in such form as the Secretary may prescribe) the benefits of this subsection not later than the date which is 2 years after the date the Secretary has begun collection activities with respect to the individual making the election,

then the other individual shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such understatement.

> (2) Apportionment of relief. -- If an individual who, but for paragraph (1)(C), would be relieved of liability under paragraph (1), establishes that in signing the return such individual did not know, and had no reason to know, the extent of such understatement, then such individual shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent that such liability is attributable to the portion of such understatement of which such individual did not know and had no reason to know.

Section 6015(c) provides in relevant part:

> SEC. 6015(c). Procedures to Limit Liability For Taxpayers No Longer Married or Taxpayers Legally Separated or Not Living Together. --
>
> (1) In general. -- Except as provided in this subsection, if an individual who has made a joint return for any taxable year elects the application of this subsection, the individual's liability for any deficiency which is assessed with respect to the return shall not exceed the portion of such deficiency properly allocable to the individual under subsection (d).
>
> * * * * * * *
>
> (3)(C) Election not valid with respect to certain deficiencies. -- If the Secretary demonstrates that an individual making an election under this subsection had actual knowledge, at the time such individual signed the return, of any item giving rise to a deficiency (or portion thereof) which is not allocable to such individual under subsection (d), such election shall not apply to such deficiency (or portion). This subparagraph shall not apply where the individual with actual knowledge establishes that such individual signed the return under duress.

Section 6015(d) specifies how an allocation under section 6015(c) is to be made, providing in relevant part:

SEC. 6015(d). Allocation of Deficiency. -- For purposes of [section 6015(c)] --

> (1) In general. -- The portion of any deficiency on a joint return allocated to an individual shall be the amount which bears the same ratio to such deficiency as the net amount of items taken into account in computing the deficiency and allocable to the individual * * * bears to the net amount of all items taken into account in computing the deficiency.
>
> * * * * * * *
>
> (3) Allocation Of Items Giving Rise To The Deficiency. -- For purpose of * * * [section 6015(c)] --
>
> (A) In general. -- Except as provided in paragraphs (4) and (5), any item giving rise to a deficiency on a joint return shall be allocated to individuals filing the return in the same manner as it would have been allocated if the individuals had filed separate returns for the taxable year.
>
> (B) Exception where other spouse benefits. -- Under rules prescribed by the Secretary, an item otherwise allocable to an individual under subparagraph (A) shall be allocated to the other individual filing the joint return to the extent the item gave rise to a tax benefit on the joint return to the other individual.

> (C) Exception for fraud. -- The Secretary may provide for an allocation of any item in a manner not prescribed by subparagraph (A) if the Secretary establishes that such allocation is appropriate due to fraud of one or both individuals.

The electing spouse has the burden of proof with respect to establishing the portion of any deficiency allocable to such individual. See sec. 6015(c)(2). As with section 6015(b), an election for section 6015(c) relief must be made within 2 years from the date the Secretary begins collection activities with respect to the individual making the election. See sec. 6015(c)(3)(B).

Section 6015(f) provides:

> SEC. 6015(f). Equitable Relief. -- Under procedures prescribed by the Secretary, if --
>
> (1) taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency (or any portion of either); and
>
> (2) relief is not available to such individual under subsection (b) or (c),
>
> the Secretary may relieve such individual of such liability.

AVAILABILITY OF RELIEF TO PETITIONER

For the reasons that follow, we conclude that petitioner is not entitled to innocent spouse relief except to the extent provided below.

A. RELIEF UNDER SECTION 6015(b)

Neither party disputes that in this case the requirements of subparagraphs (A), (B), and (E) of section 6015(b)(1) have been satisfied.[4] Their dispute involves whether the requirements of subparagraphs (C) and (D) of section 6015(b)(1) have been met.

Section 6015(b)(1)(C) contains a no "knowledge of the understatement" requirement. Petitioner maintains that the standard of inquiry to be used in determining whether the putative innocent spouse knew, or had reason to know of, an understatement of tax is whether, at the time the return was signed, a reasonably prudent taxpayer in the spouse's position could be expected to know that the stated tax liability was erroneous or that further investigation was warranted. Based on this standard, petitioner posits that even though she knew of the retirement distributions and the interest income, she did not know that there was an understatement of tax on the 1992 return.

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[4] Respondent has not objected to the manner in which petitioner has raised a claim for innocent spouse relief under sec. 6015. We thus treat the raising of innocent spouse relief in the petition as a timely filed election. See *Butler v. Commissioner,* 114 T.C. 276, 281-282 (2000); *Charlton v. Commissioner,* 114 T.C. 333, 114 T.C. No. 22 (2000).

We do not agree with petitioner's standard of inquiry. The no knowledge of the understatement requirement of section 6015(b)(1)(C) is similar to that found in former section 6013(e)(1)(C). Where relief was requested under section 6013(e) with respect to the omission of income (the situation involved herein), both this Court and the Court of Appeals for the Fifth Circuit, the court to which an appeal in this case would lie, have concluded that where a spouse seeking relief has actual knowledge of the underlying transaction that produced the omitted income, innocent spouse relief is denied. See *Reser v. Commissioner,* 112 F.3d 1258, 1265 (5th Cir. 1997), affg. in part and revg. in part T.C. Memo 1995-572; *Bokum v. Commissioner,* 94 T.C. 126, 148 (1990), *affd.* 992 F.2d 1132 (11th Cir. 1993). We believe this standard applies for section 6015(b)(1) relief as well.

Here, petitioner possessed actual knowledge of the underlying transactions (the distribution of retirement proceeds and the interest earned on the Austin Telco account) that gave rise to the Cheshires' understatement of tax. Petitioner had been informed by Mr. Cheshire that he was contemplating retirement and was eligible to receive a substantial sum of money from his retirement plan. By the end of January 1992, petitioner was aware of both the retirement distribution proceeds and the existence of the Austin Telco account. In fact, Mr. Cheshire showed petitioner the deposit slip and discussed with her the purposes for which the retirement distribution proceeds would be used.

Petitioner also had actual knowledge that interest was earned on the Austin Telco account. At all times, petitioner was aware of the balance in this account and frequently wrote checks drawn on its funds. Moreover, bank statements and a

Form 1099, Interest Income, setting forth the amount of interest earned on the account were sent to petitioner's home. Thus, petitioner does not satisfy the no knowledge of the understatement requirement of section 6015(b)(1)(C). Moreover, because petitioner knew, or had reason to know, of the entire amount of the retirement distributions and the interest earned on the Austin Telco account, she is not entitled to proportionate relief under section 6015(b)(2).

B. RELIEF UNDER SECTION 6015(c)

In general, section 6015(c) allows proportionate tax relief (if a timely election is made) through allocation of the deficiency between individuals who filed a joint return and are no longer married, are legally separated, or do not reside together for a 12-month period. Such allocation, however, is not permitted if the Secretary demonstrates that the individual electing relief had actual knowledge, at the time the return was signed, of any item giving rise to a deficiency (or portion thereof) which is not allocable to such individual. See sec. 6015(c)(3)(C). For purposes of section 6015(c), unlike for purposes of section 6015(b) and (f), equitable considerations in holding the putative innocent spouse liable for unpaid tax or any deficiency are of no import.

In the instant case, neither party disputes that the principal item giving rise to the deficiency is Mr. Cheshire's receipt of the retirement distribution proceeds,[5] and that such item is allocable to him under section 6015(d). Nor is there

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[5] Petitioner does not claim sec. 6015(c) relief with respect to the omitted interest income.

any dispute that petitioner is entitled to make an election under section 6015(c) as she and Mr. Cheshire were no longer married when petitioner filed her petition in this Court. The dispute between the parties involves whether petitioner had actual knowledge, at the time the joint return was signed, of "any item giving rise to the deficiency (or portion thereof)".

Petitioner posits that because she did not know that the taxable amount of the retirement distribution was misstated on the 1992 joint return, she is entitled to section 6015(c) relief. Respondent, on the other hand, maintains that ignorance of the tax law is of no import -- if petitioner knew of the event or transaction giving rise to the deficiency (which she admits she did), then petitioner cannot obtain relief under section 6015(c).

In our opinion, the knowledge requirement of section 6015(c)(3)(C) does not require the electing spouse to possess knowledge of the tax consequences arising from the item giving rise to the deficiency or that the item reported on the return is incorrect. Rather, the statute mandates only a showing that the electing spouse actually knew of the item on the return that gave rise to the deficiency (or portion thereof). See *Wiksell v. Commissioner,* 215 F.3d 1335 (9th Cir. 2000) ("the actual knowledge inquiry in section 6015(c)(3)(C) focuses on whether the taxpayer had knowledge 'of any item giving rise to a deficiency', not on the tax deficiency itself"; Court of Appeals held that spouse demonstrated actual knowledge of certain tax items by questioning her spouse about them), affg. without published opinion *T.C. Memo* 1999-32. Here, when petitioner signed the joint return, she was aware of the amount, the source, and the date of receipt of the retirement distribution and interest. She was, however,

under a misapprehension as to the taxable amount of the retirement distribution.

We believe the knowledge standard for purposes of section 6015(c)(3)(C) is an actual and clear awareness (as opposed to reason to know) of the existence of an item which gives rise to the deficiency (or portion thereof). In the case of omitted income (such as the situation involved herein), the electing spouse must have an awareness of the omitted income.[6] Section 6015(c)(3)(C) does not require actual knowledge on the part.

We recognize that the Senate and conference reports contain the statement that "if the IRS proves that the electing spouse had actual knowledge that an item on a return is incorrect, the election will not apply to the extent any deficiency is attributable to such item." H. Conf. Rept. 105-599, at 253 (1998); see S. Rept. 105-174, at 70 (1998). Arguably, this statement conflicts with our knowledge standard for purposes of section 6015(c)(3)(C). On the other hand, it can be read merely as an example where relief is not warranted.

Section 6015(c)(3)(C) does not explicitly state or reasonably imply that relief is denied only where the electing spouse has actual knowledge that the item giving rise to the deficiency (or any portion thereof) is incorrectly reported on the return. As the Supreme Court has stated "courts must

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[6] We leave to another day the manner in which the actual knowledge standard will be applied in erroneous deduction cases. of the electing spouse as to whether the entry on the return is or is not correct.

presume that a legislature says in a statute what it means and means in a statute what it says there". *Connecticut Natl. Bank v. Germain,* 503 U.S. 249, 253-254, 117 L. Ed. 2d 391, 112 S. Ct. 1146 (1992). Were we to interpret section 6015(c)(3)(C) narrowly (by denying relief only where the electing spouse actually knows that the item giving rise to the deficiency is incorrectly reported on the return), we would be redrafting the statute, something we may not do.

We now turn to the meaning of the word "item" for purposes of section 6015(c)(3)(C). Although the word "item" is not defined in section 6015(c)(3)(C), we believe that in omitted income situations "item" refers to the item of income that should have been reported on the return . An example contained in the report issued by the Joint Committee on Taxation, accompanying RRA 1998, supports this interpretation:

> The rule that the election will not apply to the extent any deficiency is attributable to an item the electing spouse had actual knowledge of is expected to be applied by treating the item as fully allocable to both spouses. For example, a divorced couple filed a joint return during their marriage with wage income of $150,000 allocable to the wife and $30,000 of self-employment income allocable to the husband. On examination, an additional $ 20,000 of the husband's self-employment income is discovered, resulting in a deficiency of $9,000. The IRS proves that the wife had actual knowledge of $5,000 of this additional self-employment income, but had no knowledge of

> the remaining $15,000. In this case, the husband would be liable for the full amount of the deficiency, since the item giving rise to the deficiency is fully allocable to him. IN ADDITION, THE WIFE WOULD BE LIABLE FOR THE AMOUNT THAT WOULD HAVE BEEN CALCULATED AS THE DEFICIENCY BASED ON THE $5,000 OF UNREPORTED INCOME OF WHICH SHE HAD ACTUAL KNOWLEDGE. Even if the wife elects to limit the liability for the deficiency under this provision, the IRS would be allowed to collect that amount from either spouse, while the remainder of the deficiency could be collected only from the husband. [Emphasis supplied.]

Staff of Joint Comm. on Taxation, General Explanation of Tax Legislation Enacted in 1998, at 70 (J. Comm. Print 1998).

The meaning we give to an "item" that gives rise to a deficiency, for purposes of the knowledge requirement found in section 6015(c)(3)(C), is consistent with that of other sections of the Code where the word "item" is used. See, e.g., *CIA v. Sims,* 471 U.S. 159, 169, 85 L. Ed. 2d 173, 105 S. Ct. 1881 (1985) (Supreme Court looks to other statutes in defining "intelligence sources" and "confidential source[s]".) For instance, the Code defines "item" in other contexts, as follows: Section 6231(a)(3) defines "partnership item" as "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A"; section 6231(a)(5) defines "affected item" as "any item to the

extent such item is affected by a partnership item"; and section 6245 defines a "subchapter S item" as "any item of an S corporation to the extent regulations prescribed by the Secretary provide that, for purposes of * * * [subtitle F of the Code (Procedure and Administration)], such item is more appropriately determined at the corporate level than at the shareholder level." In these circumstances, "item" is defined without reference to its tax consequences. Moreover, it is clear under section 61 that an "item" is gross income from a particular source, including pensions (the type of omitted income involved in this case).

Generally, ignorance of the tax law is not a defense to a deficiency. As we have previously stated:

> We reject [the taxpayer's] assertion that she did not have "reason to know" * * * because of her insufficient legal acumen. As a practical matter, this argument is tantamount to a claim that ignorance of the law is an element of the innocent spouse defense, and, as such, is incorrect. * * * A taxpayer is presumed to have knowledge of the tax consequences of a transaction, but is not presumed to have knowledge of the transaction itself.

Bokum v. Commissioner, 94 T.C. at 150 (quoting *Stevens v. Commissioner,* 872 F.2d 1499, 1508 n.8 (11th Cir. 1989), *affg.* T.C. Memo 1988-63 (citations omitted)); *Estate of Hall v. Commissioner,* T.C. Memo 1996-93, affd. 103 F.3d 112 (3d Cir. 1996). Were we to accept the knowledge standard petitioner advocates (i.e., the putative innocent spouse is entitled to relief if she/he misunderstood or lacked knowledge

of the Internal Revenue Code (the Code)), then potentially any spouse who is not a certified public accountant or tax attorney would be allowed to escape paying income tax. We do not believe Congress intended such a result.

To conclude, petitioner had actual knowledge of the disputed item of income (the retirement distribution proceeds), as well as the amount thereof, that gave rise to the deficiency at the time she signed the joint 1992 return. The fact that petitioner did not know that the amount of the retirement distribution was misstated on the return is of no import. Consequently, the benefits of section 6015(c) are unavailable to her.

C. RELIEF UNDER SECTION 6015(f)

Section 6015(f) confers discretion on the Secretary (and the Secretary has delegated that discretion to respondent) to grant innocent spouse relief to an individual (where relief is not available under section 6015(b) or (c)) if taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or deficiency (or any portion of either). In the instant case, petitioner sought but was denied relief under section 6015(f). Petitioner maintains that respondent's refusal to grant relief to her was arbitrary, capricious, and without sound basis in fact.

Respondent acknowledges that we have jurisdiction to review his denial of innocent spouse relief under section 6015(f). See *Butler v. Commissioner,* 114 T.C. 276 (2000); Fernandez v. Commissioner, 114 T.C. 324, 114 T.C. No. 21 (2000); *Charlton v. Commissioner*, 114 T.C. 333, 114 T.C. No. 22 (2000). We review respondent's denial of equitable

relief to petitioner under an abuse of discretion standard. See *Butler v. Commissioner, supra* at 292; *Mailman v. Commissioner,* 91 T.C. 1079, 1083 (1988); *Estate of Gardner v. Commissioner,* 82 T.C. 989, 1000 (1984). This is a question of fact. See *Hospital Corp. of Am. v. Commissioner,* 81 T.C. 520, 594 (1983); *Foster v. Commissioner,* 80 T.C. 34, 160, 178 (1983), affd. in part and revd. in part on another ground 756 F.2d 1430 (9th Cir. 1985).

Petitioner's claim for innocent spouse relief was initiated in her petition to this Court. Prior to trial, respondent conceded that petitioner was entitled to relief with respect to certain items omitted from the 1992 joint return and was not liable for the section 6651(a)(1) addition to tax. Presumably before doing so, respondent followed standard procedures by reviewing his administrative files and considered petitioner's contentions.

Respondent opposes petitioner's claim for equitable relief with respect to the retirement distribution proceeds, the interest income, and the section 6662(a) accuracy-related penalty on the grounds that it would not be inequitable to hold petitioner liable for the tax on these items and that she failed to demonstrate reasonable cause in omitting these items. After taking into account the facts and circumstances presented in this case, we do not believe respondent abused his discretion in denying equitable relief to petitioner with respect to the retirement distribution proceeds and interest income or with respect to the section 6662 penalty as it relates to the omitted interest income. However, we believe respondent's denial of equitable relief to petitioner under section 6015(f) to be an abuse of his discretion as it relates to the section 6662(a) penalty applicable to the omitted retirement distribution

proceeds. The reasons for our overruling respondent's denial of relief regarding the section 6662(a) penalty applicable to the retirement distribution proceeds are as follows:

> Section 6662(a) does not apply to "any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion." Sec. 6664(c)(1). After carefully observing petitioner while testifying, we are satisfied that at the time she signed the 1992 tax return, petitioner believed that the portion of retirement distribution proceeds used to pay off the mortgage on the family residence would be nontaxable. Further, we believe petitioner acted in good faith in reaching this erroneous conclusion.

Petitioner trusted and relied upon Mr. Cheshire when it came to the preparation of their tax returns. She is an elementary school teacher, having taken no courses in accounting or tax return preparation. She asked Mr. Cheshire about the potential tax ramifications of the retirement distributions, and Mr. Cheshire assured petitioner that he had consulted with a certified public accountant and had been advised that the payment of the outstanding mortgage on the family residence and any amount rolled over into a qualified account reduced the taxable amount of the retirement distributions. Mrs. Cheshire had no reason to doubt the truthfulness of Mr. Cheshire's statement, and in fact believed him. Under these circumstances, we do not believe petitioner had an obligation to inquire further.

We conclude that petitioner would have been justified in believing that $58,163 ($ 199,771 - $42,183 (rollover) - $99,425 (mortgage repayment)) of the $199,771 retirement distributions was taxable. Indeed, $199,771 in retirement distributions was reported on the 1992 return, albeit only $56,150 was included in the calculation of income. (The record does not reveal the $2,013 difference between $58,163 and $56,150; we deem the $2,013 difference to be de minimis.) In our opinion, it is an abuse of discretion to deny relief under section 6015(f) in an addition to tax or penalty situation when on an individual basis the putative innocent spouse meets the statutory standard generally applied to all taxpayers that shows the addition to tax or penalty is inapplicable.

Given the facts and circumstances in this case, to hold petitioner liable for the entire section 6662(a) penalty would be inequitable. Consequently, we hold that respondent abused his discretion in failing to grant petitioner innocent spouse relief from the section 6662(a) penalty as it relates to the understatement regarding the omitted retirement distribution proceeds. However, we conclude that respondent did not abuse his discretion in failing to grant petitioner innocent spouse relief from the section 6662(a) penalty as it relates to the understatement regarding the omitted interest income. Petitioner knew of that income, and the record is devoid of any reason for its omission. Consistent with these conclusions, the parties should determine the exact amount of the section 6662(a) penalty due in their Rule 155 calculation.

To reflect the foregoing and respondent's concessions,

Decision will be entered under Rule 155.

Reviewed by the Court.

WELLS, CHABOT, COHEN, RUWE, WHALEN, HALPERN, LARO, FOLEY, and VASQUEZ, JJ., agree with this majority opinion.

CHIECHI, J., concurs in the result only.

* * *

THORNTON, J., CONCURRING: No relief is available under section 6015(c)(3)(C) if the Commissioner shows that the spouse seeking relief had "actual knowledge * * * of any item giving rise to a deficiency (or portion thereof)". Majority op. p.17. The majority opinion appropriately construes this statutory language to require, in the case of omitted income, "actual and clear awareness of the omitted income." Thus, I believe, the majority opinion inherently rejects respondent's argument that actual knowledge of an "item" means actual knowledge merely of the event or transaction giving rise to the deficiency. This result comports with the ameliorative purposes of section 6015(c). It is also consistent with the statutory framework. In particular, if a spouse qualifies under section 6015(c), the relief provided under section 6015(d) is an allocation between spouses of the "items" giving rise to the deficiency. In this context, "item" clearly signifies the item of omitted income, not the underlying event or transaction.

The majority opinion harmonizes with the legislative history. The relevant Senate and conference reports state that section 6015(c) provides no relief if the Commissioner proves that the spouse seeking relief had "actual knowledge that an item on a return is incorrect." What does it mean for an "item

on a return" (as opposed to the tax treatment of such an item) to be "incorrect"? In the context of omitted income, and in the light of the section 61 provisions defining gross income by reference to various "items," it most likely means that gross income from a particular source, such as a pension, is incorrectly reported (either by virtue of understatement or omission) on the return. The other statements of legislative purpose cited by the dissent evince no clear consensus about any other standard of general applicability and dictate no contrary result.

Here the question is whether Mrs. Cheshire had actual knowledge of the gross income from the pension that gave rise to the deficiency. Clearly she did. Whether she believed the pension proceeds distribution was nontaxable in whole or part on the ground that it was used to pay down a mortgage or under some other mistaken theory is immaterial.

WHALEN, HALPERN, LARO, FOLEY, and VASQUEZ, JJ., agree with this concurring opinion.

* * *

PARR, J., DISSENTING: I have joined with Judge Colvin in his dissenting opinion, because I believe the language of section 6015(c)(3)(C) is ambiguous and that we should consult legislative history for guidance in resolving that ambiguity. I write separately only to express my concern about the Court's application of section 6013(e) case law to the case at hand.

Section 6015 is a remedial statute, therefore, its provisions should be construed and applied liberally in favor

of those whom the statute was designed to benefit. Cf. *Helvering v. Bliss,* 293 U.S. 144, 150-151, 79 L. Ed. 246, 55 S. Ct. 17 (1934); *Allen v. Commissioner,* 514 F.2d 908, 915 (5th Cir. 1975). Moreover, it is apparent that Congress intended section 6015 to provide broader relief than that provided by section 6013(e).

In its discussion of section 6015(f), the majority has found -- and I agree -- that, considering the facts and circumstances of this case, it is not inequitable to hold petitioner liable for the deficiency. Since equitable consideration is also a requirement for relief under section 6015(b)(1)(D), the majority's discussion of section 6015(b)(1)(C) is unnecessary. The word "understatement" used in section 6015(b)(1)(C) is different from the word "item" construed in the discussion of section 6015(c)(3)(C). Yet the majority treats both as synonymous with "transaction". I would defer this discussion to a case that required it.[1]

Accordingly, I respectfully dissent.

COLVIN and MARVEL, JJ., agree with this dissenting opinion.

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[1] The facts of *Charlton v. Commissioner,* 114 T.C. 333, 114 T.C. No. 22 (2000), are distinguishable, and the discussion of sec. 6015(b) therein is thus not determinative.

COLVIN, J., DISSENTING: Section 6015(c)(3)(C) provides that the separate liability election is not available if the Commissioner proves that the putative innocent spouse "had actual knowledge * * * of any item giving rise to a deficiency". The majority holds that in omitted income cases:

> Section 6015(c)(3)(C) does not require actual knowledge on the part of the electing spouse as to whether the entry on the return is or is not correct. [Majority op. pp. 19-20.]

I respectfully dissent because the majority's construction of section 6015(c)(3)(C) squarely conflicts with the legislative history of section 6015(c). I also dissent because the majority fails to discuss *Charlton v. Commissioner,* 114 T.C. 333, 114 T.C. No. 22 (2000), and relies on *Wiksell v. Commissioner,* 215 F.3d 1335 (9th Cir. 2000) (unpublished), affg. T.C. Memo 1999-32, which did not present the issue we face here.

I. THE PHRASE "ITEM GIVING RISE TO A DEFICIENCY" IS AMBIGUOUS

Section 6015(c)(3)(C) provides in pertinent part that:

> [i]f the Secretary demonstrates that an individual making an election under this subsection had actual knowledge, at the time such individual signed the return, of ANY ITEM GIVING RISE TO A DEFICIENCY (or portion thereof) which is not allocable to such individual under subsection (d), such election

> shall not apply to such deficiency (or portion).
> * * * [Emphasis added.]

Sec. 6015(c)(3)(C).

Thus, section 6015(c) relief is not available if the Commissioner proves that the putative innocent spouse had actual knowledge of any "item giving rise to a deficiency". That phrase is ambiguous; the "item" of which the putative innocent spouse must have had actual knowledge could be either of two things. First, it might refer to a transaction or activity. If so, then, as respondent contends, see majority op. at 18, a putative innocent spouse would not qualify for the separate liability election under section 6015(c) if the Commissioner showed that he or she knew that an income-producing transaction or activity had occurred.

Alternatively, knowledge of an "item giving rise to a deficiency" might refer to knowledge that an entry on a tax return was incorrect. Under this interpretation, the putative innocent spouse would not be disqualified under section 6015(c) merely because he or she knew that the income-producing transaction or activity giving rise to the deficiency had occurred. Instead, the Commissioner would be required to show that the electing spouse had actual knowledge that the treatment of the item on the tax return was incorrect.[1]

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[1] That "item giving rise to a deficiency" could be reasonably construed in either of these ways is demonstrated by the fact that the Internal Revenue Code uses the term "item" to refer both to an underlying activity and to the tax return treatment of an activity. As an example of the former, sec. 61(a) provides that --

II. STATUTORY CONTEXT AND LEGISLATIVE HISTORY MAKE SECTION 6015(c) CLEAR

A. SECTION 6015(C) COMPARED TO FORMER SECTION 6013(e)(1)(C)

In an unreported income case, a taxpayer failed to qualify for innocent spouse relief under former section 6013(e)(1)(C) if the taxpayer had knowledge of the transaction which led to the understatement. See *Reser v. Commissioner*, 112 F.3d 1258, 1267 (5th Cir. 1997). The instant case is also an unreported income case, and respondent contends we should apply the same standard here. See majority op. at 18.

> SEC. 61(a). * * * Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> > (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
> >
> > (2) Gross income derived from business;

As an example of the latter, sec. 57(a) refers to various "items of tax preference", all of which are defined by reference to tax consequences. Thus, the phrase "item giving rise to a deficiency" in sec. 6015(c)(3)(C), actual knowledge of which causes a putative innocent spouse to fail to qualify under sec. 6015(c), is reasonably subject to more than one interpretation.

Congress enacted sweeping changes to the innocent spouse provisions in 1998. In addition to liberalizing section 6013(e)(1)(C) in new section 6015(b), Congress also provided two additional forms of innocent spouse relief: the separate liability election (section 6015(c)) and authority for the Secretary to grant relief on equitable grounds (section 6015(f)). Congress also enacted a different knowledge requirement in section 6015(c)(3)(C) than had applied in former section 6013(e)(1)(C). First, section 6015(c)(3)(C) places the burden of proof on the Commissioner; under former section 6013(e) it was on the taxpayer. Second, section 6015(c)(3)(C) requires that the putative innocent spouse's knowledge be actual; former section 6013(e)(1)(C) required only that the putative innocent spouse "know or have reason to know". Third, section 6015(c) requires that the putative innocent spouse had the requisite knowledge "at the time such individual signed the return"; former section 6013(e)(1)(C) required that he or she had the requisite knowledge "in signing the return". Fourth, section 6015(c) requires that the putative innocent spouse have the requisite knowledge of "any item giving rise to a deficiency"; former section 6013(e)(1)(C) required that the putative innocent spouse know "that there was such substantial understatement". These broad structural changes, and the specific changes to the knowledge requirement, dictate that we be cautious in applying interpretations of former section 6013(e)(1)(C) to section 6015(c).

B. LEGISLATIVE HISTORY

As stated, the knowledge requirement in section 6015(c) is reasonably subject to different interpretations. We may consider legislative history to resolve statutory

ambiguity. See *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340, 136 L. Ed. 2d 808, 117 S. Ct. 843 (1997); *Golden Rod Farms, Inc. v. United States*, 115 F.3d 897, 899 (11th Cir. 1997). We especially should respect legislative history where there is unequivocal evidence of legislative purpose. See *Huntsberry v. Commissioner*, 83 T.C. 742, 747-748 (1984).

The separate liability election provisions originated in the Senate version of section 6015.[2] The legislative history consistently shows that Congress intended "actual knowledge" to be knowledge that the return is incorrect.

First, the Senate Committee on Finance report states that a putative innocent spouse will not qualify for relief under section 6015(c) if the Commissioner shows that he or she had actual knowledge that any item on the return was incorrect. The Senate Committee on Finance report provides that:

> if the IRS proves that THE ELECTING SPOUSE HAD ACTUAL KNOWLEDGE THAT AN ITEM ON A RETURN IS INCORRECT, the election will not apply to the extent any deficiency is attributable to such item. [Emphasis added.]

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[2] Under the Senate version of sec. 6015(c), the separate liability election was a complete substitute for innocent spouse relief under sec. 6013(e). Under the conference agreement and as enacted, sec. 6013(e) was repealed and reenacted in liberalized form as sec. 6015(b), and the separate liability election was provided as an alternative, available only to individuals no longer married, legally separated, or living apart for at least 12 months.

S. Rept. 105-174, at 59 (1998).

Second, the Senate Committee on Finance report, in the "Reasons for Change" section, stated the following with respect to the separate liability election:

> The Committee intends that this election be available to limit the liability of spouses for tax attributable to items of which they had no knowledge. The Committee is concerned that taxpayers not be allowed to abuse these rules BY KNOWINGLY SIGNING FALSE RETURNS, or by transferring assets for the purpose of avoiding the payment of tax by the use of this election. The Committee believes that rules restricting the liability of taxpayers to limit their liability in such situations are appropriate. [Emphasis added.]

S. Rept. 105-174, at 55-56 (1998). Thus, the Senate Committee on Finance equated "actual knowledge" with "knowingly signing [a] false return".

Third, Senator Graham said the following in offering amendments to section 6015(c) (unanimously adopted by the Senate) on behalf of himself and other Senate Committee on Finance members:

> The primary exception [to allocable liability under section 6015(c)] was that if the Secretary of the Treasury could demonstrate -- and the burden is on the Secretary of the Treasury to demonstrate -- that an individual making this

> election to be taxed only for their proportional share of the deficiency of the return, that IF THEY HAD ACTUAL KNOWLEDGE OF THE CONDITIONS WITHIN THAT RETURN WHICH LED TO THIS DEFICIENCY, then they would be 100 percent responsible. [Senate Floor Debate for Amendment No. 2369, 144 Cong. Rec. 56, S4473; emphasis supplied]

Senator D'Amato, also a member of the Senate Committee on Finance, said:

> THERE WERE CONCERNS, AND RIGHTLY SO, THAT SOME TAXPAYERS MAY TRY TO ABUSE THE INNOCENT SPOUSE RULES BY KNOWINGLY SIGNING FALSE RETURNS, or transferring assets for the purpose of avoiding the payment of tax, and then claim to be innocent. Obviously, no one would want to open the door to that type of fraud. As such, language was included in the bill that would prevent an individual from electing the innocent spouse provision if they had "actual knowledge of any item giving rise to a deficiency." [Emphasis added.]

Id.

Fourth, using language identical to that used by the Senate Committee on Finance, the conference report states that a putative innocent spouse will not qualify for relief under

section 6015(c) if he or she had actual knowledge that any item on the return was incorrect. The conference report states that:

> if the IRS proves that THE ELECTING SPOUSE HAD ACTUAL KNOWLEDGE THAT ANY ITEM ON A RETURN IS INCORRECT, the election will not apply to the extent any deficiency is attributable to such item. [Emphasis added.]

H. Conf. Rept. 105-599, at 253 (1998). Thus, the legislative history unequivocally shows that Congress intended to require the Commissioner to prove that the putative innocent spouse knew that his or her tax return was incorrect. [3]

The passage from the legislative history on which the majority relies relates to the allocation of items between the two spouses when one qualifies for the separate liability election. See majority op. at 21. It does not describe the knowledge requirement, interpretation of which is at issue here, and thus does not address this issue. Further, statutory

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[3] Contrary to the suggestion that this language might merely be an example of a situation where relief is not warranted, the above-quoted passage from the conference report and the identical language from the Finance Committee report are explanations of the statutory rule, not examples. The Finance Committee report and the conference report have a specific way to present examples. First, they state a general point; then they state "For example, * * *" to illustrate the point. This pattern is repeated seven times in the Finance Committee's explanation of sec. 6015 and seven times in the conference report's explanation of sec. 6015.

language in the allocation rule undermines the majority's position. Section 6015(d)(3)(A) provides that:

> (A) In general. -- Except as provided in paragraphs (4) and (5), ANY ITEM giving rise to a deficiency on a joint return SHALL BE ALLOCATED to individuals filing the return in the same manner as it would have been allocated if the individuals had filed separate returns for the taxable year. [Emphasis added.]

The text of section 6015(d)(3)(A) implies that an "item giving rise to a deficiency" is an item on the return rather than a underlying transaction or activity because an amount on a return can be allocated, i.e., split, but an underlying transaction or activity cannot.

Thus, the legislative history accompanying enactment of section 6015(c) clearly shows that Congress intended the knowledge requirement to mean knowledge that the return is incorrect, not knowledge that there was an income-producing activity or transaction. See S. Rept. 105-174, at 59 (1998), H. Conf. Rept. 105-599, at 253 (1998). The majority fails to apply that standard. See majority op. at 20.

The majority's reliance on the TEFRA partnership rules (sections 6231 and 6245) to construe "item" is not persuasive because those sections do not speak to the interpretative issue we face under section 6015(c)(3)(C).

III. THE MAJORITY DISREGARDS THE REQUIREMENT IN THE CONFERENCE REPORT THAT THE COMMISSIONER PROVE THAT THE PUTATIVE INNOCENT SPOUSE KNEW THAT AN ITEM ON THE RETURN WAS "INCORRECT"

As stated above, the majority holds that, in omitted income cases, section 6015(c)(3)(C) does not require actual knowledge on the part of the electing spouse as to whether the entry on the return is or is not correct. See majority op. at 20. [4]

The majority concludes that petitioner inquired in good faith as to whether her return was correct, she was assured that it was correct, and she had no obligation to inquire further. See majority op. at 26. In explaining its holding that it was an abuse of discretion for respondent not to grant equitable relief under section 6015(f) as to petitioner's liability for the section 6662(a) accuracy-related penalty, the majority states:

> we are satisfied that at the time she signed the 1992 tax return, petitioner believed that the

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[4] The majority also suggests another standard; i.e., that "the electing spouse must have an actual and clear awareness of the omitted income." See majority op. p. 19. If sec. 6015(c)(3)(C) is unambiguous, we need not create another standard; if it is ambiguous, legislative history provides the standard; i.e., that relief is not available if the Commissioner proves that the electing spouse had actual knowledge that any item on a return is incorrect.

> portion of retirement distribution proceeds used to pay off the mortgage on the family residence would be nontaxable. Further, we believe that petitioner acted in good faith in reaching this erroneous conclusion.
>
> * * * * * * *
>
> [Petitioner] asked Mr. Cheshire about the potential tax ramifications of the retirement distributions, and in response, Mr. Cheshire assured petitioner that he had consulted with certified public accountant and had been advised that the payment of the outstanding mortgage on the family residence and any amount rolled over into a qualified account reduced the taxable amount of the retirement distributions. Mrs. Cheshire had no reason to doubt the truthfulness of Mr. Cheshire's statement, and in fact believed him. Under these circumstances, we do not believe petitioner had an obligation to inquire further.

Majority op. at 25-26.

In short, the majority holds that petitioner thought the reporting of the distributions on her tax return was correct. Thus, in holding for respondent, the majority disregards the requirement in the Senate Committee on Finance report and conference report that the putative innocent spouse know something was "incorrect". See majority op. at 20.

IV. WIKSELL V. COMMISSIONER

The taxpayer in *Wiksell v. Commissioner,* 215 F.3d 1335 (9th Cir. 2000) (unpublished), affg. T.C. Memo 1999-32, knew that checks she received from her husband's business had not been reported on their 1994 and 1995 tax returns. See id. at 2000-1336, 88-983. She also had actual knowledge that the return was incorrect. See the findings of fact in *Wiksell v. Commissioner,* T.C. Memo 1994-99.

The issue in Cheshire is whether knowledge of an "item giving rise to a deficiency" refers to the putative innocent spouse's knowledge of the underlying activity, or knowledge that the income, deduction, loss, or credit from the activity is incorrectly reported on the tax return. The opinion of the U.S. Court of Appeals for the Ninth Circuit in *Wiksell v. Commissioner, supra,* does not discuss the "knowledge that any item on the return is incorrect" language from the legislative history. The opinion of the Court of Appeals does not say the parties disputed, or that the Court of Appeals considered, whether the actual knowledge of "any item giving rise to a deficiency" required by section 6015(c) is knowledge of an income- producing transaction, or knowledge that it was reported incorrectly. In fact, since Mrs. Wiksell knew her return was wrong, the Court of Appeals had no need to consider that issue.

V. CHARLTON v. COMMISSIONER

In *Charlton v. Commissioner,* 114 T.C. 333, 114 T.C. No. 22 (2000), the putative innocent spouse knew of and had access to correct information about his then-wife's income-producing activity. See *Charlton,* 114 T.C. at 341. Even

though the putative innocent spouse in Charlton knew that his wife had an income-producing Schedule C business, we concluded that the Commissioner failed to show that the putative innocent spouse had knowledge when he signed the return of any item giving rise to a deficiency. See *id.* Thus, Charlton may be cited for the proposition (contrary to respondent's position in Cheshire, majority op. at 18) that knowledge of the income-producing activity does not bar relief under section 6015(c).

The majority finds that petitioner knew that Mr. Cheshire received retirement distributions and interest on the Austin Telco account in 1992, and that she knew the amounts of the retirement distributions and interest. See majority op. pp. 4, 16, 23. However, the majority's failure to discuss Charlton will inevitably cause confusion because, both here and in Charlton, we found that the putative innocent spouse knew of the activity which gave rise to the deficiency. Under the doctrine of stare decisis we generally follow the holding of a previously decided published opinion of the Tax Court or explain why we are not doing so. This is especially true when our prior published opinion involves statutory construction. See *Hesselink v. Commissioner,* 97 T.C. 94, 99-100 (1991).

The majority concludes that the knowledge requirement of section 6015(c) does not require the electing spouse to know that the item on the return is incorrect, see majority op. pp. 19-20, and points out that petitioner knew the amount of the unreported income. See majority op. p. 23. In contrast, the putative innocent spouse in Charlton did not know the amount of unreported income from his then- wife's business. This might be how the majority would distinguish Charlton from the instant case; i.e., that knowledge of an

income- producing transaction or activity does not cause a putative innocent spouse to fail to qualify for the separate liability election unless the putative innocent spouse knew the amount of income involved. If the majority is promulgating this factual distinction as a new standard, it should so state.

PARR, GALE, and MARVEL, JJ.,
agree with this dissenting opinion.

APPENDIX D

TITLE 26. INTERNAL REVENUE CODE

SUBTITLE F. PROCEDURE AND ADMINISTRATION
CHAPTER 61. INFORMATION AND RETURNS
SUBCHAPTER A. RETURNS AND RECORDS
PART II. TAX RETURNS OR STATEMENTS
SUBPART B. INCOME TAX RETURNS

26 USCS § 6015 (2002)

§6015.Relief from joint and several liability on joint return.

(a) In general. Notwithstanding section 6013(d)(3)--
(1) an individual who has made a joint return may elect to seek relief under the procedures prescribed under subsection (b); and
(2) if such individual is eligible to elect the application of subsection (c), such individual may, in addition to any election under paragraph (1), elect to limit such individual's liability for any deficiency with respect to such joint return in the manner prescribed under subsection (c).

Any determination under this section shall be made without regard to community property laws.

(b) Procedures for relief from liability applicable to all joint filers.

(1) In general. Under procedures prescribed by the Secretary, if–

(A) a joint return has been made for a taxable year;

(B) on such return there is an understatement of tax attributable to erroneous items of one individual filing the joint return;

(C) the other individual filing the joint return establishes that in signing the return he or she did not know, and had no reason to know, that there was such understatement;

(D) taking into account all the facts and circumstances, it is inequitable to hold the other individual liable for the deficiency in tax for such taxable year attributable to such understatement; and

(E) the other individual elects (in such form as the Secretary may prescribe) the benefits of this subsection not later than the date which is 2 years after the date the Secretary has begun collection activities with respect to the individual making the election,

then the other individual shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such understatement.

(2) Apportionment of relief. If an individual who, but for paragraph (1)(C), would be relieved of liability under

paragraph (1), establishes that in signing the return such individual did not know, and had no reason to know, the extent of such understatement, then such individual shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent that such liability is attributable to the portion of such understatement of which such individual did not know and had no reason to know.

(3) Understatement. For purposes of this subsection, the term "understatement" has the meaning given to such term by section 6662(d)(2)(A).

(c) Procedures to limit liability for taxpayers no longer married or taxpayers legally separated or not living together.

(1) In general. Except as provided in this subsection, if an individual who has made a joint return for any taxable year elects the application of this subsection, the individual's liability for any deficiency which is assessed with respect to the return shall not exceed the portion of such deficiency properly allocable to the individual under subsection (d).

(2) Burden of proof. Except as provided in subparagraph (A)(ii) or (C) of paragraph (3), each individual who elects the application of this subsection shall have the burden of proof with respect to establishing the portion of any deficiency allocable to such individual.

(3) Election.

(A) Individuals eligible to make election.

(i) In general. An individual shall only be eligible to elect the application of this subsection if--

(I) at the time such election is filed, such individual is no longer married to, or is legally separated from, the individual with whom such individual filed the joint return to which the election relates; or

(II) such individual was not a member of the same household as the individual with whom such joint return was filed at any time during the 12-month period ending on the date such election is filed.

(ii) Certain taxpayers ineligible to elect. If the Secretary demonstrates that assets were transferred between individuals filing a joint return as part of a fraudulent scheme by such individuals, an election under this subsection by either individual shall be invalid (and section 6013(d)(3) shall apply to the joint return).

(B) Time for election. An election under this subsection for any taxable year may be made at any time after a deficiency for such year is asserted but not later than 2 years after the date on which the Secretary has begun collection activities with respect to the individual making the election.

(C) Election not valid with respect to certain deficiencies. If the Secretary demonstrates that

an individual making an election under this subsection had actual knowledge, at the time such individual signed the return, of any item giving rise to a deficiency (or portion thereof) which is not allocable to such individual under subsection (d), such election shall not apply to such deficiency (or portion). This subparagraph shall not apply where the individual with actual knowledge establishes that such individual signed the return under duress.

(4) Liability increased by reason of transfers of property to avoid tax.

(A) In general. Notwithstanding any other provision of this subsection, the portion of the deficiency for which the individual electing the application of this subsection is liable (without regard to this paragraph) shall be increased by the value of any disqualified asset transferred to the individual.

(B) Disqualified asset. For purposes of this paragraph--

(i) In general. The term "disqualified asset" means any property or right to property transferred to an individual making the election under this subsection with respect to a joint return by the other individual filing such joint return if the principal purpose of the transfer was the avoidance of tax or payment of tax.

(ii) Presumption.

(I) In general. For purposes of clause (i), except as provided in subclause (II), any transfer which is made after the date which is 1 year before the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent shall be presumed to have as its principal purpose the avoidance of tax or payment of tax.

(II) Exceptions. Subclause (I) shall not apply to any transfer pursuant to a decree of divorce or separate maintenance or a written instrument incident to such a decree or to any transfer which an individual establishes did not have as its principal purpose the avoidance of tax or payment of tax.

(d) Allocation of deficiency. For purposes of subsection (c)--

(1) In general. The portion of any deficiency on a joint return allocated to an individual shall be the amount which bears the same ratio to such deficiency as the net amount of items taken into account in computing the deficiency and allocable to the individual under paragraph (3) bears to the net amount of all items taken into account in computing the deficiency.

(2) Separate treatment of certain items. If a deficiency (or portion thereof) is attributable to--

(A) the disallowance of a credit; or
(B) any tax (other than tax imposed by section 1 or 55) required to be included with the joint return;
and such item is allocated to one individual under paragraph (3), such deficiency (or portion) shall be allocated to such individual. Any such item shall not be taken into account under paragraph (1).
(3) Allocation of items giving rise to the deficiency. For purposes of this subsection--
(A) In general. Except as provided in paragraphs (4) and (5), any item giving rise to a deficiency on a joint return shall be allocated to individuals filing the return in the same manner as it would have been allocated if the individuals had filed separate returns for the taxable year.
(B) Exception where other spouse benefits. Under rules prescribed by the Secretary, an item otherwise allocable to an individual under subparagraph (A) shall be allocated to the other individual filing the joint return to the extent the item gave rise to a tax benefit on the joint return to the other individual.
(C) Exception for fraud. The Secretary may provide for an allocation of any item in a manner not prescribed by subparagraph (A) if the Secretary establishes that such allocation is appropriate due to fraud of one or both individuals.
(4) Limitations on separate returns disregarded. If an item of deduction or credit

is disallowed in its entirety solely because a separate return is filed, such disallowance shall be disregarded and the item shall be computed as if a joint return had been filed and then allocated between the spouses appropriately. A similar rule shall apply for purposes of section 86.

(5) Child's liability. If the liability of a child of a taxpayer is included on a joint return, such liability shall be disregarded in computing the separate liability of either spouse and such liability shall be allocated appropriately between the spouses.

(e) Petition for review by Tax Court.

(1) In general. In the case of an individual against whom a deficiency has been asserted and who elects to have subsection (b) or (c) apply--

(A) In general. In addition to any other remedy provided by law, the individual may petition the Tax Court (and the Tax Court shall have jurisdiction) to determine the appropriate relief available to the individual under this section if such petition is filed--

(i) at any time after the earlier of--

(I) the date the Secretary mails, by certified or registered mail to the taxpayer's last known address, notice of the Secretary's final determination of relief available to the individual, or

(II) the date which is 6 months after the date such election is filed with the Secretary, and

(ii) not later than the close of the 90th day after the date described in clause (i)(I).

(B) Restrictions applicable to collection of assessment.

(i) In general. Except as otherwise provided in section 6851 or 6861, no levy or proceeding in court shall be made, begun, or prosecuted against the individual making an election under subsection (b) or (c) for collection of any assessment to which such election relates until the close of the 90-day period referred to in subparagraph (A)(ii), or, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Rules similar to the rules of section 7485 shall apply with respect to the collection of such assessment.

(ii) Authority to enjoin collection actions. Notwithstanding the provisions of section 7421(a), the beginning of such levy or proceeding during the time the prohibition under clause (i) is in force may be enjoined by a proceeding in the proper court, including the Tax Court. The Tax Court shall have no jurisdiction under this subparagraph to enjoin any action

or proceeding unless a timely petition has been filed under subparagraph (A) and then only in respect of the amount of the assessment to which the election under subsection (b) or (c) relates.

(2) Suspension of running of period of limitations. The running of the period of limitations in section 6502 on the collection of the assessment to which the petition under paragraph (1)(A) relates shall be suspended--

(A) for the period during which the Secretary is prohibited by paragraph (1)(B) from collecting by levy or a proceeding in court and for 60 days thereafter, and

(B) if a waiver under paragraph (5) is made, from the date the claim for relief was filed until 60 days after the waiver is filed with the Secretary.

(3) Limitation on tax court jurisdiction. If a suit for refund is begun by either individual filing the joint return pursuant to section 6532--

(A) the Tax Court shall lose jurisdiction of the individual's action under this section to whatever extent jurisdiction is acquired by the district court or the United States Court of Federal Claims over the taxable years that are the subject of the suit for refund, and

(B) the court acquiring jurisdiction shall have jurisdiction over the petition filed under this subsection.

(4) Notice to other spouse. The Tax Court shall establish rules which provide the

individual filing a joint return but not making the election under subsection (b) or (c) with adequate notice and an opportunity to become a party to a proceeding under either such subsection.

(5) Waiver. An individual who elects the application of subsection (b) or (c) (and who agrees with the Secretary's determination of relief) may waive in writing at any time the restrictions in paragraph (1)(B) with respect to collection of the outstanding assessment (whether or not a notice of the Secretary's final determination of relief has been mailed).

(f) Equitable relief. Under procedures prescribed by the Secretary, if--

(1) taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency (or any portion of either); and

(2) relief is not available to such individual under subsection (b) or (c),

the Secretary may relieve such individual of such liability.

(g) Credits and refunds.

(1) In general. Except as provided in paragraphs (2) and (3), notwithstanding any other law or rule of law (other than section 6511, 6512(b), 7121, or 7122), credit or refund shall be allowed or made to the extent attributable to the application of this section.

(2) Res judicata. In the case of any election under subsection (b) or (c), if a decision of a court in any prior proceeding for the same taxable year has become final, such decision shall be conclusive except with respect to the qualification of the individual for relief which was not an issue in such proceeding. The exception contained in the preceding sentence shall not apply if the court determines that the individual participated meaningfully in such prior proceeding.

(3) Credit and refund not allowed under subsection (c). No credit or refund shall be allowed as a result of an election under subsection (c).

(h) Regulations. The Secretary shall prescribe such regulations as are necessary to carry out the provisions of this section, including--

(1) regulations providing methods for allocation of items other than the methods under subsection (d)(3); and

(2) regulations providing the opportunity for an individual to have notice of, and an opportunity to participate in, any administrative proceeding with respect to an election made under subsection (b) or (c) by the other individual filing the joint return.